

No. 17507-8-9

United States
Court of Appeals
for the Ninth Circuit

MAX KUNEY, JR., and CONSTANCE K.
KUNEY, His Wife; MAX J. KUNEY, SR.,
OLIVE R. KUNEY,

Appellants,

vs.

WILLIAM E. FRANK, DISTRICT DIRECTOR
OF INTERNAL REVENUE,

Appellee.

Transcript of Record

Appeals from the United States District Court for the
Western District of Washington,
Northern Division.

FILED

DEC 11 1961

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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In the District Court of the United States in the
Western District of Washington, Northern
Division

No. 4990

MAX J. KUNEY, JR., and CONSTANCE K.
KUNEY, Husband and Wife,

Plaintiffs,

vs.

WILLIAM E. FRANK,

Defendant.

COMPLAINT

Plaintiffs for their first cause of action allege as follows:

I.

This action is brought under Title 28, United States Code, Section 1340, and under the Internal Revenue Laws of the United States, as hereunder more fully appears.

II.

The plaintiffs herein are and at all times material hereto were husband and wife, citizens of the United States, and over the age of twenty-one (21) years. At all times material hereto plaintiffs have resided in the City of Spokane, County of Spokane, State of Washington.

III.

The defendant herein is and at all times material hereto was the duly appointed and acting District Director of Internal Revenue for the District of Washington, and said defendant is now residing within the Western Judicial District of Washington.

IV.

Plaintiffs herein timely filed their Federal Income Tax Returns for the taxable years 1952, 1953 and 1954, with the defendant at Tacoma, Washington, and paid said defendant the following amounts of tax, shown as due on their returns as filed: 1952, \$133,988.06; 1953, \$26,840.04; 1954, \$19,557.12.

V.

That subsequent to the time that the plaintiffs filed their original Federal Income Tax Returns and on or about November 15, 1954, plaintiffs filed an amended Federal Income Tax Return for the taxable year 1952 with the defendant at Tacoma, Washington, and attached thereto a claim for refund of federal income tax for the taxable year 1952 in the amount of \$20,827.04, plus interest. A copy of the refund claim as filed is attached hereto, marked Exhibit "A," and made a part of this complaint by reference.

VI.

That thereafter the Commissioner of Internal Revenue, by and through his agents, conducted an audit investigation of the income tax returns as filed. On or about the 20th day of November, 1957, the Commissioner of Internal Revenue mailed a notice of deficiency (90 day letter) to the plaintiffs in which he determined that the said plaintiffs herein owed additional income tax for the taxable year 1952 in the amount of \$7,960.92, plus interest.

VII.

That the said additional tax, plus interest, was predicated upon the theory of the Commissioner of Internal Revenue that Max J. Kuney Company, a partnership between Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, minor children of plaintiffs Max J. Kuney, Jr., and Constance K. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney, minor child of Max J. Kuney, Sr., and Olive R. Kuney, was invalid for federal income tax purposes, and that therefore the income of Max J. Kuney Company should be taxed only to Max J. Kuney, Sr., Olive R. Kuney, Max J. Kuney, Jr., and Constance K. Kuney.

VIII.

That in response to the determination of the Commissioner, as set out above, plaintiffs, on or about the 5th day of February, 1958, paid to the defendant at his Spokane, Washington, office, the sum of \$10,297.07 for the taxable year 1952, which sum included the additional tax asserted to be due, plus interest at the rate of 6 per cent (6%) per annum.

IX.

That on or about the 19th day of April, 1958, the plaintiffs filed with the defendant at Tacoma, Washington, a timely second claim for refund of federal income tax for the taxable year 1952 in the total amount of \$35,076.95, plus interest. The said claim was predicated principally upon the

ground that Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1952. A copy of the second refund claim and riders thereto as filed is attached hereto, marked Exhibit "B," and made a part of the complaint by reference.

X.

That the plaintiffs' first claim for refund for the taxable year 1952, as set forth in paragraph V above, was disallowed by the Commissioner of Internal Revenue by registered mail under date of March 18, 1958.

XI.

That the plaintiffs' second claim for refund for the taxable year 1952, as set forth in paragraph IX above, was disallowed by the Commissioner of Internal Revenue by registered mail under date of September 15, 1958.

XII.

That Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1952, consisting of Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr. as trustee for Max J. Kuney III and Caroline I. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney.

XIII.

That by reason of the payment of tax, as set forth in paragraphs IV and VIII above, and by reason of facts set forth herein and in the refund claims attached hereto, there is now due and owing

to the plaintiffs the sum of \$35,076.95, together with interest on the amount of \$24,779.88 at six per cent (6%) per annum from March 15, 1953, until paid, and interest on the amount of \$10,297.07 at six per cent (6%) per annum from February 5, 1958, until paid, said amount having been illegally and erroneously collected by the defendant from the plaintiffs for the taxable year 1952.

Plaintiffs for their second cause of action allege as follows:

XIV.

Plaintiffs reallege paragraphs I, II, III and IV of their first cause of action in haec verba.

XV.

That subsequent to the time that the plaintiffs filed their original Federal Income Tax Return and on or about November 15, 1954, plaintiffs filed an amended Federal Income Tax Return for the taxable year 1953 with the defendant at Tacoma, Washington, and attached thereto a claim for refund of federal income tax for the taxable year 1953 in the amount of \$2,012.70, plus interest. A copy of the refund claim as filed is attached hereto, marked Exhibit "C," and made a part of this complaint by reference.

XVI.

That thereafter the Commissioner of Internal Revenue, by and through his agents, conducted an audit investigation of the income tax returns as filed. On or about the 20th day of November, 1957,

the Commissioner of Internal Revenue mailed a notice of deficiency (90 day letter) to the plaintiffs in which he determined that there had been an overassessment of income tax for the taxable year 1953 in the amount of \$99.72, plus interest.

XVII.

That the failure of the Commissioner of Internal Revenue to determine a larger overassessment was predicated upon the theory that Max J. Kuney Company, a partnership between Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, minor children of plaintiffs Max J. Kuney, Jr., and Constance K. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney, minor child of Max J. Kuney, Sr. and Olive R. Kuney, was invalid for federal income tax purposes, and that therefore the income of Max J. Kuney Company should be taxed only to Max J. Kuney, Sr., Max J. Kuney, Jr. and Constance K. Kuney.

XVIII.

That on or about the 19th day of April, 1958, the plaintiffs filed with the defendant at Tacoma, Washington, a timely second claim for refund of federal income taxes for the taxable year 1953 in the total amount of \$5,085.09, plus interest. The said claim was predicated principally upon the ground that Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1953. A copy of the second

refund claim and riders thereto as filed is attached hereto, marked Exhibit "D," and made a part of the complaint by reference.

XIX.

That the plaintiffs' first claim for refund for the taxable year 1953, as set forth in paragraph XV above, was allowed in the amount of \$59.72, credited in the amount of \$40.00, and disallowed as to the remainder by the Commissioner of Internal Revenue by registered mail under date of March 18, 1958.

XX.

That the plaintiffs' second claim for refund for the taxable year 1953, as set forth in paragraph XVIII above, was disallowed by the Commissioner of Internal Revenue by registered mail under date of September 15, 1958.

XXI.

That Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1953, consisting of Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney.

XXII.

That by reason of the payment of tax, as set forth in paragraph IV above, and by reason of the allowance of an overassessment in the amount of \$99.72, as set forth in paragraph XIX above, which overassessment has been refunded or credited to

plaintiffs, and by reason of facts set forth herein and the refund claims attached hereto, there is now due and owing to the plaintiffs the sum of \$5,085.09, together with interest thereon at the rate of 6 per cent (6%) per annum from March 15, 1954, until paid, said amount having been illegally and erroneously collected by the defendant from the plaintiffs for the taxable year 1953.

Plaintiffs as their third cause of action allege as follows:

XXIII.

Plaintiffs reallege paragraphs I, II, III and IV of their first cause of action in haec verba.

XXIV.

That subsequent to the time that the plaintiffs filed their Federal Income Tax Return for the taxable year 1954, as set out in paragraph IV above, the Commissioner of Internal Revenue, by and through his agents, conducted an audit investigation of the income tax return as filed. On or about the 20th day of November, 1957, the Commissioner of Internal Revenue mailed a notice of deficiency (90 day letter) to the plaintiffs in which he determined that the said plaintiffs herein owed additional income tax for the taxable year 1954 in the amount of \$7,689.71, plus interest.

XXV.

That the said additional tax, plus interest, was predicated upon the theory of the Commissioner of Internal Revenue that Max J. Kuney Company, a

partnership between Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, minor children of plaintiffs Max J. Kuney, Jr. and Constance K. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney, minor child of Max J. Kuney, Sr. and Olive R. Kuney, was invalid for federal income tax purposes, and that therefore the income of Max J. Kuney Company should be taxed only to Max J. Kuney, Sr., Max J. Kuney, Jr. and Constance K. Kuney.

XXVI.

That in response to the determination of the Commissioner, as set out above, plaintiffs, on or about the 5th day of February, 1958, paid to the defendant at his Spokane, Washington, office, the sum of \$8,-272.78 for the taxable year 1954, which sum included the additional tax asserted to be due, plus interest at the rate of 6 per cent (6%) per annum.

XXVII.

That on or about the 19th day of April, 1958, the plaintiffs filed with the defendant at Tacoma, Washington, a timely claim for refund of federal income tax for the taxable year 1954 in the total amount of \$5,791.67, plus interest. The said claim was predicated principally upon the ground that Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1954. A copy of the refund claim and riders thereto as filed is attached hereto, marked Exhibit "E," and made a part of the complaint by reference.

XXVIII.

That the plaintiffs' claim for refund for the taxable year 1954, as set forth in paragraph XXVII above, was disallowed by the Commissioner of Internal Revenue by registered mail under date of September 15, 1958.

XXIX.

That Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1954, consisting of Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney.

XXX.

That by reason of the payment of taxes, as set forth in paragraphs IV and XXVI above, and by reason of the facts set forth herein and in the refund claims attached hereto, there is now due and owing to the plaintiffs the sum of \$5,791.67, together with interest thereon at the rate of 6 per cent (6%) per annum from February 5, 1958, until paid, said amount having been illegally and erroneously collected by the defendant from the plaintiffs for the taxable year 1954.

Wherefore, it is prayed that the Court hear this proceeding and render Judgment for the plaintiffs in the amount of \$35,076.95 for the taxable year 1952; \$5,085.09 for the taxable year 1953, and \$5,791.67 for the taxable year 1954, together with

interest at the rate of 6 per cent (6%) per annum as is provided by law.

WITHERSPOON, KELLEY,
DAVENPORT & TOOLE,

/s/ W. W. WITHERSPOON,

/s/ W. V. KELLEY,

/s/ ALLAN H. TOOLE.

[Endorsed]: Filed February 4, 1960.

In the District Court of the United States in the
Western District of Washington, Northern
Division

No. 4991

MAX J. KUNEY, SR.,

Plaintiffs,

vs.

WILLIAM E. FRANK,

Defendant.

COMPLAINT

Plaintiff for his first cause of action alleges as follows:

I.

This action is brought under Title 28, United States Code, Section 1340, and under the Internal Revenue Laws of the United States, as hereunder more fully appears.

II.

The plaintiff herein is and at all times material hereto was a citizen of the United States, and over the age of twenty-one (21) years. At all times material hereto plaintiff has resided in the City of Seattle, County of King, State of Washington.

III.

The defendant herein is and at all times material hereto was the duly appointed and acting District Director of Internal Revenue for the District of Washington, and said defendant is now residing within the Western Judicial District of Washington.

IV.

Plaintiff herein timely filed his Federal Income Tax Returns for the taxable years 1952, 1953 and 1954, with the District Director of Internal Revenue at Tacoma, Washington, and paid the following amounts of tax, shown as due on his returns as filed: 1952, \$104,119.17; 1953, \$22,605.64; 1954, \$11,510.76.

V.

That subsequent to the time that the plaintiff filed his original Federal Income Tax Returns and on or about November 15, 1954, plaintiff filed an amended Federal Income Tax Return for the taxable year 1952 with the defendant at Tacoma, Washington, and attached thereto a claim for refund of federal income tax for the taxable year 1952 in the amount of \$10,956.16, plus interest. A copy of the refund claim as filed is attached hereto, marked

Exhibit "A," and made a part of this complaint by reference.

VI.

That thereafter the Commissioner of Internal Revenue, by and through his agents, conducted an audit investigation of the income tax returns as filed. On or about the 20th day of November, 1957, the Commissioner of Internal Revenue mailed a notice of deficiency (90 day letter) to the plaintiff in which he determined that the said plaintiff herein owed additional income tax for the taxable year 1952 in the amount of \$1,087.24, plus interest.

VII.

That the said additional tax, plus interest, was predicated upon the theory of the Commissioner of Internal Revenue that Max J. Kuney Company, a partnership between Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, minor children of Max J. Kuney, Jr. and Constance K. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney, minor child of Max J. Kuney, Sr., and Olive R. Kuney, was invalid for federal income tax purposes, and that therefore the income of Max J. Kuney Company should be taxed only to Max J. Kuney, Sr., Olive R. Kuney, Max J. Kuney, Jr., and Constance K. Kuney.

VIII.

That in response to the determination of the Commissioner, as set out above, plaintiff, on or about the 5th day of February, 1958, paid to the

District Director of Internal Revenue, Spokane, Washington, office, the sum of \$1,406.29 for the taxable year 1952, which sum included the additional tax asserted to be due, plus interest at the rate of 6 per cent (6%) per annum.

IX.

That on or about the 19th day of April, 1958, the plaintiff filed with the District Director of Internal Revenue at Tacoma, Washington, a timely second claim for refund of federal income tax for the taxable year 1952 in the total amount of \$13,662.39, plus interest. The said claim was predicated principally upon the ground that Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1952. A copy of the second refund claim and riders thereto as filed is attached hereto, marked Exhibit "B," and made a part of the complaint by reference.

X.

That the plaintiff's first claim for refund for the taxable year 1952, as set forth in paragraph V above, was disallowed by the Commissioner of Internal Revenue by registered mail under date of March 18, 1958.

XI.

That the plaintiff's second claim for refund for the taxable year 1952, as set forth in paragraph IX above, was disallowed by the Commissioner of Internal Revenue by registered mail under date of September 15, 1958.

XII.

That Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1952, consisting of Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney.

XIII.

That by reason of the payment of tax, as set forth in paragraphs IV and VIII above, and by reason of facts set forth herein and in the refund claims attached hereto, there is now due and owing to the plaintiff the sum of \$13,662.39, together with interest on the amount of \$12,256.10 at six per cent (6%) per annum from March 15, 1953, until paid, and interest on the amount of \$1,406.29 at six per cent (6%) per annum from February 5, 1958, until paid, said amount having been illegally and erroneously collected by the defendant from the plaintiff for the taxable year 1952.

Plaintiff for his second cause of action alleges as follows:

XIV.

Plaintiff realleges paragraphs I, II, III and IV of his first cause of action in haec verba.

XV.

That subsequent to the time that the plaintiff filed his original Federal Income Tax Return and on or about November 15, 1954, plaintiff filed an

amended Federal Income Tax Return for the taxable year 1953 with the defendant at Tacoma, Washington, and attached thereto a claim for refund of federal income tax for the taxable year 1953 in the amount of \$2,212.86, plus interest. A copy of the refund claim as filed is attached hereto, marked Exhibit "C," and made a part of this complaint by reference.

XVI.

That thereafter the Commissioner of Internal Revenue, by and through his agents, conducted an audit investigation of the income tax returns as filed. On or about the 20th day of November, 1957, the Commissioner of Internal Revenue mailed a notice of deficiency (90 day letter) to the plaintiff in which he determined that there had been an overassessment of income tax for the taxable year 1953 in the amount of \$1,427.23, plus interest.

XVII.

That the failure of the Commissioner of Internal Revenue to determine a larger overassessment was predicated upon the theory that Max J. Kuney Company, a partnership between Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, minor children of Max J. Kuney, Jr. and Constance K. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney, minor child of Max J. Kuney, Sr. and Olive R. Kuney, was invalid

for federal income tax purposes, and that therefore the income of Max J. Kuney Company should be taxed only to Max J. Kuney, Sr., Max J. Kuney, Jr. and Constance K. Kuney.

XVIII.

That on or about the 19th day of April, 1958, the plaintiff filed with the defendant at Tacoma, Washington, a timely second claim for refund of federal income taxes for the taxable year 1953 in the total amount of \$4,149.57, plus interest. The said claim was predicated principally upon the ground that Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1953. A copy of the second refund claim and riders thereto as filed is attached hereto, marked Exhibit "D," and made a part of the complaint by reference.

XIX.

That the plaintiff's first claim for refund for the taxable year 1953, as set forth in paragraph XV above, was allowed in the amount of \$1,427.23 and disallowed as to the remainder by the Commissioner of Internal Revenue by registered mail under date of March 18, 1958.

XX.

That the plaintiff's second claim for refund for the taxable year 1953, as set forth in paragraph XVIII above, was disallowed by the Commissioner

of Internal Revenue by registered mail under date of September 15, 1958.

XXI.

That Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1953, consisting of Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney.

XXII.

That by reason of the payment of tax, as set forth in paragraph IV above, and by reason of the allowance of an overassessment in the amount of \$1,427.23, as set forth in paragraph XIX above, which overassessment has been refunded or credited to plaintiff, and by reason of facts set forth herein and the refund claims attached hereto, there is now due and owing to the plaintiff the sum of \$4,149.57, together with interest thereon at the rate of 6 per cent (6%) per annum from March 15, 1954, until paid, said amount having been illegally and erroneously collected by the defendant from the plaintiffs for the taxable year 1953.

Plaintiff as his third cause of action alleges as follows:

XXIII.

Plaintiff realleges paragraphs I, II, III and IV of his first cause of action in haec verba.

XXIV.

That subsequent to the time that the plaintiff filed his Federal Income Tax Return for the taxable year 1954, as set out in paragraph IV above, the Commissioner of Internal Revenue, by and through his agents, conducted an audit investigation of the income tax return as filed. On or about the 20th day of November, 1957, the Commissioner of Internal Revenue mailed a notice of deficiency (90 day letter) to the plaintiff in which he determined that the said plaintiff herein owed additional income tax for the taxable year 1954 in the amount of \$7,080.12, plus interest.

XXV.

That the said additional tax, plus interest, was predicated upon the theory of the Commissioner of Internal Revenue that Max J. Kuney Company, a partnership between Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, minor children of Max J. Kuney, Jr. and Constance K. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney, minor child of Max J. Kuney, Sr. and Olive R. Kuney, was invalid for federal income tax purposes, and that therefore the income of Max J. Kuney Company should be taxed only to Max J. Kuney, Sr., Max J. Kuney, Jr. and Constance K. Kuney.

XXVI.

That in response to the determination of the Commissioner, as set out above, plaintiff, on or

about the 5th day of February, 1958, paid to the defendant at his Spokane, Washington, office, the sum of \$8,272.78 for the taxable year 1954, which sum included the additional tax asserted to be due, plus interest at the rate of 6 per cent (6%) per annum.

XXVII.

That on or about the 19th day of April, 1958, the plaintiff filed with the District Director of Internal Revenue at Tacoma, Washington, a timely claim for refund of federal income tax for the taxable year 1954 in the total amount of \$5,011.14, plus interest. The said claim was predicated principally upon the ground that Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1954. A copy of the refund claim and riders thereto as filed is attached hereto, marked Exhibit "E," and made a part of the complaint by reference.

XXVIII.

That the plaintiff's claim for refund for the taxable year 1954, as set forth in paragraph XXVII above, was disallowed by the Commissioner of Internal Revenue by registered mail under date of September 15, 1958.

XXIX.

That Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1954, consisting of Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee

for Max J. Kuney III and Caroline I. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney.

XXX.

That by reason of the payment of taxes, as set forth in paragraphs IV and XXVI above, and by reason of the facts set forth herein and in the refund claims attached hereto, there is now due and owing to the plaintiff the sum of \$5,011.14, together with interest thereon at the rate of 6 per cent (6%) per annum from February 5, 1958, until paid, said amount having been illegally and erroneously collected by the defendant from the plaintiff for the taxable year 1954.

Wherefore, it is prayed that the Court hear this proceeding and render Judgment for the plaintiff in the amount of \$13,662.39 for the taxable year 1952, \$4,149.57 for the taxable year 1953 and \$5,011.14 for the taxable year 1954, together with interest at the rate of 6 per cent (6%) per annum as is provided by law.

WITHERSPOON, KELLEY,
DAVENPORT & TOOLE,

/s/ W. W. WITHERSPOON,

/s/ W. V. KELLEY,

/s/ ALLAN H. TOOLE.

[Endorsed]: Filed February 4, 1960.

In the District Court of the United States in the
Western District of Washington, Northern Division

No. 4992

OLIVE R. KUNEY,

Plaintiff,

vs.

WILLIAM E. FRANK,

Defendant.

COMPLAINT

Plaintiff for her first cause of action alleges as follows:

I.

This action is brought under Title 28, United States Code, Section 1340, and under the Internal Revenue Laws of the United States, as hereunder more fully appears.

II.

The plaintiff herein is and at all times material hereto was a citizen of the United States, and over the age of twenty-one (21) years. At all times material hereto plaintiff has resided in the City of Seattle, County of King, State of Washington.

III.

The defendant herein is and at all times material hereto was the duly appointed and acting District Director of Internal Revenue for the District of Washington, and said defendant is now residing within the Western Judicial District of Washington.

IV.

Plaintiff timely filed her Federal Income Tax Return for the taxable year 1952 with the defendant at Tacoma, Washington, and paid said defendant the following amount of tax, shown as due on her return as filed: \$70,104.10.

V.

That subsequent to the time that the plaintiff filed her original Federal Income Tax Return and on or about November 15, 1954, plaintiff filed an amended Federal Income Tax Return for the taxable year 1952 with the defendant at Tacoma, Washington, and attached thereto a claim for refund of federal income tax for the taxable year 1952 in the amount of \$10,981.33, plus interest. A copy of the refund claim as filed is attached hereto, marked Exhibit "A," and made a part of this complaint by reference.

VI.

That thereafter, and on or about February 8, 1956, plaintiff filed with the defendant at Tacoma, Washington, a second timely claim for refund of federal income tax for the taxable year 1952 in the amount of \$70,104.10, plus interest. A copy of this refund claim as filed is attached hereto, marked Exhibit "B," and made a part of this complaint by reference.

VII.

That thereafter the Commissioner of Internal Revenue, by and through his agents, conducted an

audit investigation of the income tax returns as filed. On or about the 20th day of November, 1957, the Commissioner of Internal Revenue mailed a notice of deficiency (90 day letter) to the plaintiff in which he determined that the said plaintiff herein owed additional income tax for the taxable year 1952 in the amount of \$1,615.22, plus interest.

VIII.

That the said additional tax, plus interest, was predicated upon the theory of the Commissioner of Internal Revenue that Max J. Kuney Company, a partnership between Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, minor children of Max J. Kuney, Jr. and Constance K. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney, minor child of Max J. Kuney, Sr. and Olive R. Kuney, was invalid for federal income tax purposes, and that therefore the income of Max J. Kuney Company should be taxed only to Max J. Kuney, Sr., Olive R. Kuney, Max J. Kuney, Jr., and Constance K. Kuney.

IX.

That in response to the determination of the Commissioner, as set out above, plaintiff, on or about the 5th day of February, 1958, paid to the defendant at his Spokane, Washington, office, the sum of \$2,089.21 for the taxable year 1952, which sum included the additional tax asserted to be due, plus interest at the rate of 6 per cent (6%) per annum.

X.

That on or about the 19th day of April, 1958, the plaintiff filed with the defendant at Tacoma, Washington, a timely third claim for refund of federal income tax for the taxable year 1952 in the total amount of \$14,289.47, plus interest. The said claim was predicated principally but not wholly upon the ground that Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1952. A copy of the third refund claim and riders thereto as filed is attached hereto, marked Exhibit "C," and made a part of the complaint by reference.

XI.

That on or about the 9th day of February, 1959, the plaintiff filed with the defendant at Tacoma, Washington, a timely fourth claim for refund of federal income tax for the taxable year 1952 in the total amount of \$20,894.89, plus interest. This claim was predicated on the dual grounds that Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1952 and that plaintiff was entitled to an additional deduction in the amount of \$9,071.62 for fees paid to her attorney in a successful effort to obtain additional alimony from her husband for the years 1953-1957. A copy of the fourth refund claim and riders thereto as filed is attached hereto, marked Exhibit "D," and made a part of the complaint by reference.

XII.

That the plaintiff's first and second claims for refund for the taxable year 1952, as set forth in paragraphs IV and V above, were disallowed by the Commissioner of Internal Revenue by registered mail under date of March 18, 1958.

XIII.

That the plaintiff's third claim for refund for the taxable year 1952, as set forth in paragraph IX above, was disallowed by the Commissioner of Internal Revenue by registered mail under date of September 15, 1958.

XIV.

That the plaintiff's fourth claim for refund for the taxable year 1952, as set forth in paragraph XI above, was allowed in the amount of \$2,089.21 plus interest from February 5, 1958, and refund of such amount was made on or about December 1, 1959.

XV.

That Max J. Kuney Company was a valid partnership for federal income tax purposes during the taxable year 1952, consisting of Max J. Kuney, Sr., Max J. Kuney, Jr., Max J. Kuney, Sr., as trustee for Max J. Kuney III and Caroline I. Kuney, and Max J. Kuney, Jr., as trustee for John R. Kuney.

XVI.

That by reason of the payment of tax, as set forth in paragraph IV above, and by reason of

facts set forth herein and in the refund claims attached hereto, there is now due and owing to the plaintiff the sum of \$14,289.47, together with interest at six per cent (6%) per annum from March 15, 1953, until paid, said amount having been illegally and erroneously collected by the defendant from the plaintiff for the taxable year 1952.

Wherefore, it is prayed that the Court hear this proceeding and render Judgment for the plaintiff in the amount of \$20,894.89 for the taxable year 1952, together with interest at the rate of 6 per cent (6%) per annum as is provided by law.

WITHERSPOON, KELLEY,
DAVENPORT & TOOLE,

/s/ W. W. WITHERSPOON,

/s/ W. V. KELLEY,

/s/ ALLAN H. TOOLE.

[Endorsed]: Filed February 4, 1960.

[Title of District Court and Cause.]

Civil No. 4990

ANSWER

First Cause of Action

Defendant, William E. Frank, by his attorney in answer to the Complaint states:

1.

Admits the allegations contained in paragraph numbered I thereof.

2.

Admits the allegations contained in paragraph numbered II thereof.

3.

Admits the allegations contained in paragraph numbered III thereof.

4.

Admits the allegations contained in paragraph numbered IV thereof.

5.

Admits the allegations contained in paragraph numbered V thereof, except denies each and every allegation of fact set forth in the amended tax return and in the claim for refund.

6.

Admits the allegations contained in paragraph numbered VI thereof.

7.

Denies the allegations contained in paragraph numbered VII thereof, except admits that the Commissioner of Internal Revenue assessed additional taxes on the grounds that Max J. Kuney, Sr., as Trustee, and Max J. Kuney, Jr., as Trustee, are not properly recognized for tax purposes as partners in Max J. Kuney Company, a partnership.

8.

Admits the allegations contained in paragraph numbered VIII thereof.

9.

Admits the allegations contained in paragraph numbered IX thereof, except denies each and every allegation of fact set forth in the claim for refund.

10.

Admits the allegations contained in paragraph numbered X thereof.

11.

Admits the allegations contained in paragraph numbered XI thereof.

12.

Denies the allegations contained in paragraph numbered XII thereof.

13.

Denies the allegations contained in paragraph numbered XIII thereof.

Second Cause of Action

14.

Realleges the answers made in Count One in paragraphs numbered 1, 2, 3, and 4, herein.

15.

Admits the allegations contained in paragraph numbered XV thereof, except denies each and every allegation of fact set forth in the claim for refund.

16.

Admits the allegations contained in paragraph numbered XVI thereof.

17.

Denies the allegations contained in paragraph numbered XVII thereof, except admits that the Commissioner of Internal Revenue assessed additional taxes on the grounds that Max J. Kuney, Sr., as Trustee, and Max J. Kuney, Jr., as Trustee, are not properly recognized for tax purposes as partners in Max J. Kuney Company, a partnership.

18.

Admits the allegations contained in paragraph numbered XVIII thereof, except denies each and every allegation of fact set forth in the claim for refund.

19.

Admits the allegations contained in paragraph numbered XIX thereof.

20.

Admits the allegations contained in paragraph numbered XX thereof.

21.

Denies the allegations contained in paragraph numbered XXI thereof.

22.

Denies the allegations contained in paragraph numbered XXII thereof.

Third Cause of Action

23.

Realleges the answers made in Count One in paragraphs numbered 1, 2, 3, and 4, herein.

24.

Admits the allegations contained in paragraph numbered XXIV thereof.

25.

Denies the allegations contained in paragraph numbered XXV thereof, except admits that the Commissioner of Internal Revenue assessed additional taxes on the grounds that Max J. Kuney, Sr., as Trustee, and Max J. Kuney, Jr., as Trustee, are not properly recognized for tax purposes as partners in Max J. Kuney Company, a partnership.

26.

Admits the allegations contained in paragraph numbered XXVI thereof.

27.

Admits the allegations contained in paragraph numbered XXVII thereof, except denies each and every allegation of fact set forth in the claim for refund.

28.

Admits the allegations contained in paragraph numbered XXVIII thereof.

29.

Denies the allegations contained in paragraph numbered XXIX thereof.

30.

Denies the allegations contained in paragraph numbered XXX thereof.

Alternative Defense

Defendant alleges that in the event the Court should find for plaintiff that Max J. Kuney, Sr., as Trustee, and Max J. Kuney, Jr., as Trustee, were bona fide partners in Max J. Kuney Company for federal income tax purposes, plaintiff is nevertheless not entitled to a refund of the entire amount claimed, since there has been an improper allocation of partnership income among the partners as claimed in the partnership returns for the years involved. A determination for the taxpayer on the issue raised by the complaint will require a reallocation of the income to the partners giving to each the share to which he is entitled, taking into consideration the earnings due to his labor and/or his capital contribution to the partnership. It is further alleged that plaintiffs are required to prove that their taxes have been overpaid and the exact amount of such overpayment before they are entitled to any recovery of said tax.

Wherefore, defendant prays that the Complaint be dismissed with prejudice and the cost be assessed against the plaintiff.

/s/ CHARLES P. MORIARTY,
United States Attorney,
Attorney for Defendant.

Duly verified.

[Endorsed]: Filed April 4, 1960.

[Title of District Court and Cause.]

Civil No. 4991

ANSWER

First Cause of Action

Defendant, William E. Frank, by his attorney in answer to the Complaint states:

1.

Admits the allegations contained in paragraph numbered I thereof.

2.

Admits the allegations contained in paragraph numbered II thereof.

3.

Admits the allegations contained in paragraph numbered III thereof.

4.

Admits the allegations contained in paragraph numbered IV thereof.

5.

Admits the allegations contained in paragraph numbered V thereof, except denies each and every allegation of fact set forth in the amended tax return and in the claim for refund.

6.

Admits the allegations contained in paragraph numbered VI thereof.

7.

Denies the allegations contained in paragraph numbered VII thereof, except admits that the Commissioner of Internal Revenue assessed additional taxes on the grounds that Max J. Kuney, Sr., as Trustee, and Max J. Kuney, Jr., as Trustee, are not properly recognized for tax purposes as partners in Max J. Kuney Company, a partnership.

8.

Admits the allegations contained in paragraph numbered VIII thereof.

9.

Admits the allegations contained in paragraph numbered IX thereof, except denies each and every allegation of fact set forth in the claim for refund.

10.

Admits the allegations contained in paragraph numbered X thereof.

11.

Admits the allegations contained in paragraph numbered XI thereof.

12.

Denies the allegations contained in paragraph numbered XII thereof.

13.

Denies the allegations contained in paragraph numbered XIII thereof.

Second Cause of Action

14.

Realleges the answers made in Count One in paragraphs numbered 1, 2, 3, and 4, herein.

15.

Admits the allegations contained in paragraph numbered XV thereof, except denies each and every allegation of fact set forth in the claim for refund.

16.

Admits the allegations contained in paragraph numbered XVI thereof.

17.

Denies the allegations contained in paragraph numbered XVII thereof, except admits that the Commissioner of Internal Revenue assessed additional taxes on the grounds that Max J. Kuney, Sr., as Trustee, and Max J. Kuney, Jr., as Trustee, are not properly recognized for tax purposes as partners in Max J. Kuney Company, a partnership.

18.

Admits the allegations contained in paragraph numbered XVIII thereof, except denies each and every allegation of fact set forth in the claim for refund.

19.

Admits the allegations contained in paragraph numbered XIX thereof.

20.

Admits the allegations contained in paragraph numbered XX thereof.

21.

Denies the allegations contained in paragraph numbered XXI thereof.

22.

Denies the allegations contained in paragraph numbered XXII thereof.

Third Cause of Action

23.

Realleges the answers made in Count One in paragraphs numbered 1, 2, 3, and 4, herein.

24.

Admits the allegations contained in paragraph numbered XXIV thereof.

25.

Denies the allegations contained in paragraph numbered XXV thereof, except admits that the Commissioner of Internal Revenue assessed additional taxes on the grounds that Max J. Kuney, Sr., as Trustee, and Max J. Kuney, Jr., as Trustee, are not properly recognized for tax purposes as partners in Max J. Kuney Company, a partnership.

26.

Admits the allegations contained in paragraph numbered XXVI thereof.

27.

Admits the allegations contained in paragraph numbered XXVII thereof, except denies each and every allegation of fact set forth in the claim for refund.

28.

Admits the allegations contained in paragraph numbered XXVIII thereof.

29.

Denies the allegations contained in paragraph numbered XXIX thereof.

30.

Denies the allegations contained in paragraph numbered XXX thereof.

Alternative Defense

Defendant alleges that in the event the Court should find for plaintiffs that Max J. Kuney, Sr., as Trustee, and Max J. Kuney, Jr., as Trustee, were bona fide partners in Max J. Kuney Company for federal income tax purposes, plaintiffs are nevertheless not entitled to a refund of the entire amount claimed, since there has been an improper allocation of partnership income among the partners as claimed in the partnership returns for the years involved. A determination for the taxpayer on the issue raised by the complaint will require a reallocation of the income to the partners giving to each the share to which he is entitled, taking into consideration the earnings due to his labor and/or his capital contribution to the partnership. It is further

alleged that plaintiffs are required to prove that their taxes have been overpaid and the exact amount of such overpayment before they are entitled to any recovery of said tax.

Wherefore, defendant prays that the Complaint be dismissed with prejudice and the cost be assessed against the plaintiffs.

/s/ CHARLES P. MORIARTY,
United States Attorney,
Attorney for Defendant.

Duly verified.

[Endorsed]: Filed April 4, 1960.

[Title of District Court and Cause.]

Civil No. 4992

ANSWER

First Cause of Action

Defendant, William E. Frank, by his attorney in answer to the Complaint states:

1.

Admits the allegations contained in paragraph numbered I thereof.

2.

Admits the allegations contained in paragraph numbered II thereof.

3.

Admits the allegations contained in paragraph numbered III thereof.

4.

Admits the allegations contained in paragraph numbered IV thereof.

5.

Admits the allegations contained in paragraph numbered V thereof, except denies each and every allegation of fact set forth in the amended tax return and in the claim for refund.

6.

Admits the allegations contained in paragraph numbered VI thereof, except denies each and every allegation of fact set forth in the claim for refund.

7.

Admits the allegations contained in paragraph numbered VII thereof.

8.

Denies the allegations contained in paragraph numbered VIII thereof, except admits that the Commissioner of Internal Revenue assessed additional taxes on the grounds that Max J. Kuney, Sr., as Trustee, and Max J. Kuney, Jr., as Trustee, are not properly recognized for tax purposes as partners in Max J. Kuney Company, a partnership.

9.

Admits the allegations contained in paragraph numbered IX thereof.

10.

Admits the allegations contained in paragraph numbered X thereof, except denies each and every allegation of fact set forth in the claim for refund.

11.

Admits the allegations contained in paragraph numbered XI thereof, except denies each and every allegation of fact set forth in the claim for refund.

12.

Admits the allegations contained in paragraph numbered XII thereof.

13.

Admits the allegations contained in paragraph numbered XIII thereof.

14.

Admits the allegations contained in paragraph numbered XIV thereof.

15.

Denies the allegations contained in paragraph numbered XV thereof.

16.

Denies the allegations contained in paragraph numbered XVI thereof.

Alternative Defense

Defendant alleges that in the event the Court should find for plaintiff that Max J. Kuney, Sr., as

Trustee, and Max J. Kuney, Jr., as Trustee, were bona fide partners in Max J. Kuney Company for federal income tax purposes, plaintiff is nevertheless not entitled to a refund of the entire amount claimed, since there has been an improper allocation of partnership income among the partners as claimed in the partnership returns for the years involved. A determination for the taxpayer on the issue raised by the Complaint will require a reallocation of the income to the partners giving to each the share to which he is entitled, taking into consideration the earnings due to his labor and/or his capital contribution to the partnership. It is further alleged that plaintiffs are required to prove that their taxes have been overpaid and the exact amount of such overpayment before they are entitled to any recovery of said tax.

Wherefore, defendant prays that the Complaint be dismissed with prejudice and the case be assessed against the plaintiff.

/s/ CHARLES P. MORIARTY,
United States Attorney,
Attorney for Defendant.

Duly verified.

[Endorsed]: Filed April 4, 1960.

[Title of District Court and Cause.]

Civil No. 4990, 4991, and 4992

DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Pursuant to Rule 56 of the Federal Rules of Civil Procedure the defendant, by his attorney, moves the Court to enter an order of summary judgment against plaintiffs in each of the above-entitled cases on the ground that there is no genuine issue of any material fact concerning the provisions of the trust instruments created by taxpayers in 1952. A copy of each of the aforementioned trust instruments which were attached to the fiduciary returns of each of the trusts for the first taxable year (1952) are attached hereto and made a part hereof.

Without waiving any of the defenses heretofore raised by the defendant with respect to the family partnership issue, the defendant is, as a matter of law, entitled to judgment. This contention is founded on the fact that there is no issue concerning the evidentiary nature of the trust agreements. It is by virtue of said agreements that taxpayers claim to have created trustees as partners in the Max J. Kuney Company in, e.g., paragraphs VII and VIII of the complaints filed herein. The controls retained by the grantors makes the income taxable to said grantors by virtue of the pertinent sections of the Internal Revenue Code as judicially

interpreted by the Courts aside from the issues concerning the validity of the trustees as partners.

Defendant's points and authorities in support of this motion will be filed on or before the date set for hearing thereon.

/s/ CHARLES P. MORIARTY,
United States Attorney;

/s/ JOSEPH C. McKINNON,
Assistant United States
Attorney.

Certificate of service by mail attached.

[Endorsed]: Filed July 5, 1960.

[Title of District Court and Cause.]

Civil No. 4990, 4991, and 4992

PLAINTIFF'S AFFIDAVIT IN OPPOSITION
TO DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

County of Spokane,
State of Washington—ss.

I, Max J. Kuney, being first on oath duly sworn, depose and say:

I am the Trustee under that certain Trust Agreement dated February 11, 1952, between Max J. Kuney, Jr., and Constance K. Kuney, Grantors, and

myself as Trustee. I am the father of Max J. Kuney, Jr.

In my capacity as Trustee of said trust I have never been and am not now subservient to the will of the Grantor, Max J. Kuney, Jr. The Grantor expects me to and I do exercise my own judgment and discretion in the affairs of the trust estate, both with respect to the administration of the trust and distributions of income and corpus.

I am the Grantor of that certain trust dated February 11, 1952, between Max J. Kuney, as Grantor, and Max J. Kuney, Jr., as Trustee. The said Max J. Kuney, Jr., Trustee, is my son. My son in his capacity as Trustee has never been and is not now subservient to me in any manner whatsoever. I expect him to, and he does, exercise his own judgment and discretion in the affairs of such trust estate, both with respect to the administration of the trust and distributions of income and corpus.

/s/ MAX J. KUNEY.

Subscribed and sworn to before me this 20th day of July, 1960.

[Seal] /s/ ALLAN H. TOOLE,
Notary Public in and for the State of Washington,
Residing at Spokane.

[Endorsed]: Filed July 22, 1960.

[Title of District Court and Cause.]

Civil No. 4990, 4991, and 4992

PLAINTIFF'S AFFIDAVIT IN OPPOSITION
TO DEFENDANT'S MOTION FOR SUM-
MARY JUDGMENT

County of Spokane,
State of Washington—ss.

I, Max J. Kuney, Jr., being first on oath duly sworn, depose and say:

I am the Trustee under that certain Trust Agreement dated February 11, 1952, between Max J. Kuney as Grantor and myself as Trustee. I am the son of Max J. Kuney and am 42 years of age.

In my capacity as Trustee of said trust I have never been and am not now subservient to the will of the Grantor, Max J. Kuney. The Grantor expects me to and I do exercise my own judgment and discretion in the affairs of the trust estate, both with respect to the administration of the trust and distributions of income and corpus.

I am one of the Grantors of that certain trust dated February 11, 1952, between Max J. Kuney, Jr., and Constance K. Kuney as Grantors and Max J. Kuney as Trustee. The said Max J. Kuney, Trustee, is my father. My father in his capacity as Trustee has never been and is not now subservient to me in any manner whatsoever. I expect him to, and he does, exercise his own judgment and discretion in the affairs of such trust estate, both with respect to

the administration of the trust and distribution of income and corpus.

/s/ MAX J. KUNEY, JR.

Subscribed and sworn to before me this 19th day of July, 1960.

[Seal] /s/ WILLIAM B. PETERSEN,
Notary Public in and for the State of Washington,
Residing at Spokane.

[Endorsed]: Filed July 22, 1960.

[Title of District Court and Cause.]

Civil No. 4990, 4991, and 4992

MEMORANDUM DECISION

The record now before the court on defendant's motion for summary judgment, including the briefs of the parties and the authorities cited therein, has been fully examined.

Under *Helvering v. Clifford*, 309 U.S. 31 (1940), the ultimate question to be resolved in these cases is whether in each instance the trustor is shown by all of the facts and circumstances relating to the grant and conduct of the trust to be in substance and for practical purposes the owner of the trust corpus even though not technically so.

Defendant contends that an affirmative answer to the stated question is required as a matter of law on the face of the trust documents, such being the only basis on which summary judgment is sought or can be granted. In the particular circumstances now presented, the contention cannot be sustained. A trial on the merits is required to allow consideration of evidence as to all factors pertinent to the ultimate question for decision.

Defendant's motion for summary judgment is denied. Exception allowed.

Dated this 9th day of August, 1960.

/s/ GEORGE H. BOLDT,
United States District Judge.

[Endorsed]: Filed August 10, 1960.

[Title of District Court and Cause.]

Civil No. 4990, 4991, and 4992

PRE-TRIAL ORDER

As a result of pre-trial conferences heretofore had whereat the plaintiffs were represented by Allan H. Toole, E. Glenn Harmon and Scott B. Lukins, of Witherspoon, Kelley, Davenport & Toole, their attorneys, and defendant was represented by Charles P. Moriarty, United States Attorney, and Dale E. Anderson, Department of Jus-

tice, his attorneys, the following Issues of Fact and Law were framed and exhibits identified:

Admitted Facts:

The following are admitted facts:

1. These are civil actions against the District Director of Internal Revenue for the refund of income taxes paid by the plaintiffs for the years 1952, 1953 and 1954, arising under and by virtue of the Internal Revenue laws of the United States of which this Court has jurisdiction under the provisions of Title 28, United States Code, Section 1340. Said actions involve common questions of fact and law and are to be consolidated for trial pursuant to Rule 42 of the Federal Rules of Civil Procedure.

2. The plaintiffs are and at all times material hereto were citizens of the United States and over the age of 21 years. At all times material hereto the plaintiffs, Olive R. Kuney and Max J. Kuney, Sr., have resided in the City of Seattle, County of King, State of Washington, and the plaintiffs, Max J. Kuney, Jr., and Constance K. Kuney, were husband and wife, and have resided in the City of Spokane, County of Spokane, State of Washington.

3. The defendant, William E. Frank, is and at all times material hereto was duly appointed an acting District Director of Internal Revenue for the District of Washington, and said defendant is now

residing in the Western Judicial District of Washington.

4. For each of the calendar years involved in this proceeding, the plaintiffs timely filed with the defendant Federal Income tax returns indicating income taxes due, which were timely paid, as follows:

Plaintiff	Year	Amount of Tax
Olive R. Kuney.....	1952	\$ 70,104.10
Max J. Kuney, Sr.	1952	69,447.03
Max J. Kuney, Sr.	1953	22,605.64
Max J. Kuney, Sr.	1954	11,510.76
Max J. Kuney, Jr., and Constance K. Kuney.....	1952	133,988.06
Max J. Kuney, Jr., and Constance K. Kuney.....	1953	26,840.04
Max J. Kuney, Jr., and Constance K. Kuney.....	1954	19,557.12

5. On or about November 20, 1957, the Commissioner of Internal Revenue mailed to plaintiffs his statutory notices of deficiency ("90 Day Letter") determining deficiencies and overassessments against the plaintiffs for the years involved in this proceeding. On or about February 5, 1958, the plaintiffs paid or caused to be paid to the defendant the deficiencies so determined together with interest thereon and on or about March 31, 1958, the Commissioner paid to the plaintiffs the overassessments so determined together with interest thereon as follows:

Plaintiff	Calendar Year	Deficiency or (Overassessment) Determined	Interest Paid by Plaintiffs (Defendant)
Olive R. Kuney.....	1952	\$1,615.22	\$ 473.99
Olive R. Kuney.....	1952	(1,615.22)*	(692.87)
Max J. Kuney, Sr.	1952	1,087.24	319.05
Max J. Kuney, Sr.	1953	(1,427.23)	(343.94)
Max J. Kuney, Sr.	1954	7,080.12	1,192.66
Max J. Kuney, Jr., and Constance K. Kuney.....	1952	7,960.92	2,336.15
Max J. Kuney, Jr., and Constance K. Kuney.....	1953	(59.72)	(14.39)
Max J. Kuney, Jr., and Constance K. Kuney.....	1954	7,689.71	1,295.35

*Paid on or about December 1, 1959.

6. Timely claims for refund were filed by plaintiffs and were disallowed by registered letter from the Commissioner of Internal Revenue as follows:

Name	Date Claim Filed	Date Claim Disallowed	Taxable Year	Amount of Claim
Olive R. Kuney.....	12/ 2/54	3/18/58	1952	\$10,981.33
	2/20/56	3/18/58	1952	70,104.10
	4/22/58	9/15/58	1952	14,289.47
	Partial Refund			
	2/13/59	11/24/59	1952	20,894.89
Max J. Kuney, Sr.....	12/ 2/54	3/18/58	1952	10,956.16
	2/13/56	3/18/58	1952	69,366.03
	4/12/58	9/15/58	1952	13,662.39
	12/ 2/54	2/18/58	1953	2,212.86
	4/10/58	9/15/58	1953	4,149.57
	4/12/58	9/15/58	1954	5,011.14
Max J. Kuney, Jr., & Constance K. Kuney	12/ 2/54	3/18/58	1952	20,827.04
	4/16/58	9/15/58	1952	35,076.95
	12/ 2/54	3/18/58	1953	2,012.70
	4/16/58	9/15/58	1953	5,085.09
	4/16/58	9/15/58	1954	5,791.67

These claims for refund were predicated principally upon the claim that Max J. Kuney Company was a valid partnership consisting of the following persons:

1. Max J. Kuney, Sr. (and his wife, Olive R. Kuney, as community property, for the calendar year 1952 only);
2. Max J. Kuney, Jr. (and his wife, Constance K. Kuney, as community property, for all three calendar years);
3. Max J. Kuney, Sr. (as trustee);
4. Max J. Kuney, Jr. (as trustee).

The claims for refund now before the Court are the following:

Name	Year	Amount
Olive R. Kuney.....	1952	\$14,289.47
Max J. Kuney, Sr.	1952	13,662.39
	1953	4,149.57
	1954	5,011.14
Max J. Kuney, Jr., and	1952	35,076.95
Constance K. Kuney	1953	5,085.09
	1954	5,791.67

7. On or about February 4, 1960, the date of filing the summons and complaints herein, no statute of limitations had run which would bar any of the plaintiffs herein from bringing an action for the recovery of any or all Federal income taxes and interest thereon paid by the plaintiffs for the calendar years 1952, 1953 and 1954.

8. The salaries paid by the partnership to the partners Max J. Kuney, Sr., and Max J. Kuney, Jr., for each of the calendar years involved in this proceeding were as follows:

Partner	1952	1953	1954
Max J. Kuney, Sr.	\$25,000.00	\$10,000.00	\$5,000.00
Max J. Kuney, Jr.	25,000.00	10,000.00	5,000.00

9. The income of the partnership, Max J. Kuney Company, for each of the calendar years involved in this proceeding, which was available for distribution among the partners for Federal income tax purposes (prior to allowance of partners' salaries) was as follows:

Class of Income	1952	Calendar Year 1953	1954
Ordinary income	\$419,346.59	\$85,796.42	\$55,571.02
Net long term capital gain	31,078.49	13,807.35	63,352.58

10. On or about February 11, 1952, Max J. Kuney Jr., and Constance K. Kuney as Grantors, and Max J. Kuney, Sr., as Trustee, made and executed a Trust Agreement, a copy of which is attached hereto as Plaintiffs' Exhibit No. 1.

11. On or about February 11, 1952, Max J. Kuney, Sr., as Grantor, and Max J. Kuney, Jr., as Trustee, made and executed a Trust Agreement, a copy of which is attached hereto as Exhibit No. 2.

12. The plaintiffs, Max J. Kuney, Jr., and Constance K. Kuney, each duly and timely filed with the District Director of Internal Revenue at Tacoma, Washington, Federal gift tax returns for the calen-

dar year 1952, each indicating a gift to Max J. Kuney, Sr., as Trustee under the Trust Agreement attached hereto as Plaintiffs' Exhibit No. 1 of one-half of an undivided interest in the donors' capital account in the partnership of Max J. Kuney Company equal to the sum of \$100,000.00. Copies of said Federal gift tax returns are attached hereto as Exhibits 3 and 4. Said plaintiffs also filed Washington State gift tax returns with Inheritance Tax Division of the Washington State Tax Commission at Olympia, Washington, for said calendar year indicating said gift. Copies of said Washington State gift tax returns are attached hereto as Exhibits 5 and 6. The plaintiffs, Max J. Kuney, Jr., and Constance K. Kuney, each duly and timely paid to the District Director of Internal Revenue the gift tax due as disclosed by said Federal gift tax returns, and to the Washington State Inheritance Tax Division the gift tax due as disclosed by said State gift tax returns.

13. The plaintiff, Max J. Kuney, Sr., duly and timely filed with the District Director of Internal Revenue at Tacoma, Washington, a Federal gift tax return for the calendar year 1952, indicating a gift to Max J. Kuney, Jr., as Trustee under the Trust Agreement attached hereto as Exhibit No. 2 of an undivided interest in the donor's capital account in the partnership of Max J. Kuney Company equal to the sum of \$100,000.00. A copy of said Federal gift tax return is attached hereto as Plaintiffs' Exhibit No. 7. Said plaintiff also filed a Washington State

gift tax return with the Inheritance Tax Division of the Washington State Tax Commission at Olympia, Washington, for said calendar year indicating said gift. A copy of said Washington State gift tax return is attached hereto as Exhibit No. 8. The plaintiff, Max J. Kuney, Sr., duly and timely paid to the District Director of Internal Revenue the gift tax due as disclosed by said gift tax return, and duly and timely paid to the Washington State Tax Commission the gift tax due as disclosed by said State gift tax return.

14. During each of the calendar years involved in this proceeding capital was a material income producing factor in the partnership of Max J. Kuney Company.

15. During each of the following calendar years the following distributions of trust income were made in cash by Max J. Kuney as Trustee to the following named beneficiaries of the trusts created by Max J. Kuney, Jr., and Constance K. Kuney, to wit:

Date	Distributee (Beneficiary)	Trust for Benefit of		
		Caroline I. Kuney	Max J. Kuney, III	John Richardson Kuney
1952	Caroline I. Kuney.....	\$10,000.00		
	Max J. Kuney, III		\$10,000.00	
	Lorraine B. Kuney.....	1,800.00	1,800.00	
	C. H. & Mabel Bentley....	2,400.00	2,400.00	
	John R. Kuney.....			\$18,788.72
1953	Lorraine B. Kuney.....	1,000.00	1,000.00	
	C. H. & Mabel Bentley....	2,400.00	2,400.00	
1954	C. H. & Mabel Bentley....	2,400.00	2,400.00	

16. For each of the calendar years involved in this proceeding, the partnership timely filed Federal partnership income tax returns. Copies of said income tax returns are attached hereto as plaintiffs' Exhibits 9 through 11 as shown by the following table:

Partnership Return of Income for Year	Exhibit Number
1952 (original)	9
1952 (amended)	10
1953 (original)	11
1953 (amended)	12
1954	13

17. For each of the calendar years involved in this proceeding, Max J. Kuney, Jr., as Trustee for John R. Kuney; Max J. Kuney as Trustee for Caroline I. Kuney; and Max J. Kuney as Trustee for Max J. Kuney, III, timely filed Federal fiduciary income tax returns and paid the income taxes due per said returns. Copies of said income tax returns are attached hereto as plaintiffs' Exhibits 14 through 22, as shown by the following table:

Taxpayer	Year	Tax Paid	Exhibit Number
Max J. Kuney, Jr., as Trustee for John R. Kuney.....	1952	\$7,157.96	14
Max J. Kuney, Jr., as Trustee for John R. Kuney.....	1953	2,012.54	15
Max J. Kuney, Jr., as Trustee for John R. Kuney.....	1954	1,211.58	16
Max J. Kuney as Trustee for Caroline I. Kuney.....	1952	2,378.00	17
Max J. Kuney as Trustee for Caroline I. Kuney.....	1953	268.70	18
Max J. Kuney as Trustee for Caroline I. Kuney.....	1954	286.72	19

Taxpayer	Year	Tax Paid	Exhibit Number
Max J. Kuney, Sr., as Trustee for Max J. Kuney, III.....	1952	2,378.00	20
Max J. Kuney, Sr., as Trustee for Max J. Kuney, III.....	1953	268.70	21
Max J. Kuney, Sr., as Trustee for Max J. Kuney, III.....	1954	286.72	22

Said amounts of tax plus interest was refunded to the trusts by the Commissioner of Internal Revenue.

Issues of Fact

The following are the Issues of Fact to be determined by the jury herein:

1. Under all the facts and circumstances, were the trusts hereinabove referred to, created by Max J. Kuney, Sr., and by Max J. Kuney, Jr., and Constance K. Kuney, valid and effective transfers in trust for Federal income tax purposes? The answer to this question depends on all the facts and circumstances surrounding the creation of said trusts, the conduct and operation of the business and of the trusts and the rights and duties contained in the pertinent instruments.

2-A. Was Max J. Kuney, Sr., as Trustee of the trust created by Max J. Kuney, Jr., and Constance K. Kuney, subservient to the wishes of the Grantor, Max J. Kuney, Jr., in deciding to accumulate the remaining trust income for the benefit of the minor beneficiaries rather than distributing the same? If he were subservient, then one-half of the trust income is taxable to such grantor for the year 1954.

B. Was Max J. Kuney, Jr., as Trustee of the trust created by Max J. Kuney, Sr., subservient to the wishes of said Grantor in deciding to accumulate the income of the trust for the benefit of the minor beneficiary rather than distributing the same? If he was subservient, defendant is entitled to judgment for the year 1954.

3-A. During each of the calendar years involved in this proceeding, was Max J. Kuney, Sr., as Trustee under the Trust Agreement hereinabove referred to, the real owner for Federal income tax purposes of a partnership interest in Max J. Kuney Company, a partnership? Did the grantor retain controls over the trust property which were inconsistent with a bona fide transfer of ownership?

B. During each of the calendar years involved in this proceeding, was Max J. Kuney, Jr., as Trustee under the Trust Agreement hereinabove referred to, the real owner for Federal income tax purposes of a partnership interest in Max J. Kuney Company, a partnership? Did the grantor retain controls over the trust property which were inconsistent with a bona fide transfer of ownership.

4. Were the salaries paid to Max J. Kuney, Sr., and Max J. Kuney, Jr., during each of the calendar years involved in this proceeding by Max J. Kuney Company, a partnership, reasonable compensation for services rendered to the partnership by said persons? If not, what were reasonable salaries to be paid to such persons during such years for such purposes?

5. There is no issue of fact regarding the legality of the trusts under the Laws of Washington. There is an issue of fact as to the validity of the trusts as partners in the Max J. Kuney Company under the Laws of Washington.

Issues of Law

1. Does the Court's denial of defendant's motion for summary judgment herein preclude further consideration at this time of whether the grantors are taxable on the trust income as a matter of law under Section 167 of the 1939 Code or Section 677 of the 1954 Code? If the answer to this question is negative, then the following Issues of Law are presented:

(a) Was the income of each of the trusts distributable to the grantors of those trusts by the respective trustees as parents within the meaning of Section 167 of the 1939 Code and of Section 677 of the 1954 Code?

(b) As a matter of law, are any funds which may be distributed to a parent-grantor under Art. I, Sec. 6 (of the trust wherein Max J. Kuney, Sr. is the grantor) or Art. II, Sec. 7 (of the trust wherein Max J. Kuney, Jr., and Constance K. Kuney are the grantors) of the trusts subject to any fiduciary obligation on the part of the parent-grantor in the application or use thereof?

2. Were the trusts hereinabove mentioned legal and valid members of the partnership of Max J. Kuney Company during the years involved in this

proceeding under the laws of the State of Washington? Among the factors to be considered are:

(a) Under the laws of the State of Washington, is the legal existence of a partnership affected in any manner by such partnership's failure to file a certificate of assumed business name as described in R.C.W. 19.80.010?

(b) Under R.C.W. 19.80.010, is a partnership required to file a certificate of assumed business name where its name is "Max J. Kuney Co.," and the partners thereof are Max J. Kuney, individually and as trustee for others, and Max J. Kuney, Jr., individually and as trustee for another?

3. Are the Treasury Regulations 118, Sec. 39.22 (a)-21(d) to be given the force and effect of law? If they are to be given the effect of law, are they applicable to these cases?

Plaintiffs' Contentions

1. By means of the trust agreements described above a gift of a capital interest worth \$100,000.00 in the partnership of Max J. Kuney Company was made by Max J. Kuney, Sr., and a gift of a capital interest worth \$50,000.00 was made by Max J. Kuney, Jr. and a similar gift was made by Constance K. Kuney.

2. The trusts created by the Trust Agreements referred to above were valid and effective trusts for Federal income tax purposes and the income of the trusts during each of the calendar years involved in this proceeding was properly taxed to the trust,

or, in the case of distributed income, to the beneficiaries thereof.

3. The Trustees under the aforesaid trusts became, under the laws of the State of Washington, valid and legal members of the partnership of Max J. Kuney Company, a partnership, and the following partners were the real owners of their respective capital interests in the partnership for Federal income tax purposes:

A. Max J. Kuney Sr. (and Olive R. Kuney, as community property, for the calendar year 1952 only);

B. Max J. Kuney Jr. (and Constance K. Kuney, as community property, for the calendar years 1952, 1953 and 1954);

C. Max J. Kuney, Sr., as Trustee; and

D. Max J. Kuney, Jr., as Trustee.

4. The salaries paid by the partnership of Max J. Kuney, Sr., and Max J. Kuney, Jr., during each of the calendar years involved in this proceeding were not less than reasonable compensation to said persons for services rendered to the partnership by said persons.

5. During the calendar years involved in this proceeding, the net income of the partnership (after deduction of reasonable salaries paid to Max J. Kuney, Sr., and Max J. Kuney, Jr.) was properly distributed for Federal income tax purposes among the partners in accordance with the profit sharing ratio described in the Stipulation below.

6. By reason of the Court's denial of defendant's motion for a summary judgment herein, the Court has determined that the income of the trust is not taxable to the Grantors as a matter of law under Sec. 167 of the 1939 Code and Sec. 677 of the 1954 Code. In any event, if a trustee were to distribute income to the parent-grantor pursuant to the terms of either trust, such funds would be held by the parent-grantor in a fiduciary capacity; under no circumstances would such a distribution be to a "grantor" within the meaning of Section 677(a) of the 1954 Code or Section 167 of the 1939 Code.

7. Neither of the trustees was subservient to the wishes of the grantors of the respective trusts in the year 1954 in deciding to accumulate or distribute trust income.

8. R.C.W. 19.80.010 relating to filing a certificate of assumed business name has no relevance to the legal existence of a partnership under the laws of the State of Washington. In any event, a proper certificate of assumed business name was filed with the County Clerk of Spokane County, Washington.

Defendant's Contentions

1. That as a matter of law a trustee is not an adverse party to a trust unless he has a beneficial interest in the trust corpus.

2. That the trusts provided that income of the trusts could be distributed to the grantors of the trusts.

3. That the grantors of these trusts are not trustees as to their own children unless so appointed by a Court of law or by a legal document which designates them as trustee for such purpose.

4. That no such designation of these parents as trustee for their own children was ever made by any legal document or legal action.

5. That because of the existence of the facts alleged in paragraphs 1 through 4 supra the defendant is entitled as a matter of law to prevail pursuant to section 167 of the 1939 Code and section 677 of the 1954 Code. That this section is not controlled by the so-called "Clifford" rules since it has been in the Code since 1924 and is subject to being literally interpreted by this Court.

6. That the plaintiffs of this action did not comply with the statute of the State of Washington in creating a valid and legally existing partnership.

7. That plaintiffs merely assigned a share of the partnership income to the trusts which they set up and did not make the trusts partners as such.

8. That even if the plaintiffs did convey a part of the capital of the partnership to the trusts that the plaintiffs retained too many strings on the transfer of such capital. There was no bona fide transfer of the entire bundle of ownership rights in this property.

This is so because:

(a) The trustees were the partners themselves.

(b) The trustees were not required by any provision in the trust instrument to ever pay any of the corpus to the beneficiaries named in the trust.

(c) The trustees were not required by any provision in the trust instrument to ever pay to the named beneficiaries any of the income accrued before each such beneficiary reached the age of 30.

(d) That the trustees therefore retained absolute control over this trust corpus and income accumulated to age 30 until 21 years after the death of each named beneficiary of the trust.

(e) The trustees and grantors were related as father and son.

(f) The trustees and grantors were related as partners in the Max J. Kuney Company.

(g) That the grantors did transfer a substantial part of the original partnership business to a corporation in which the trusts have no interest. The trusts were not compensated for the loss of value upon such transfer.

(h) That the grantor-trustees had absolute control over the amount of salaries to be drawn by them as partners.

(i) That the grantor-trustees had control over how much income would go to the trusts by controlling the rental rate on equipment leased to a corporation controlled by the grantor-trustees.

(j) That the grantor-trustees had unrestricted power to either increase or decrease their own cap-

ital accounts and thus change the share of the income to be distributed to the trusts.

(k) That the grantor-trustees had unrestricted power to reduce the trust capital accounts and thus increase or reduce the trust's share of the profits. Trust capital could be withdrawn and investment elsewhere or even kept in the business but in the form of loans at fixed interest rather than as capital interests entitled to a share of the profits.

9. That the trustee-grantors were subservient to each other both directly and indirectly in their relationship as partners in the Max J. Kuney Company, and as father and son.

10. That section 167 of the 1939 Code and section 677 of the 1954 Code requires that any trust income be taxed to the grantors of these trusts.

11. That section 674 of the 1954 Code requires that the grantors of these trusts be taxed on the income therefrom for the year 1954 because taxpayers cannot prove by a preponderance of the evidence that they are not subservient parties as provided by section 672(c) of the 1954 Code.

12. That Treasury Regulations 118, Sec. 39.22 (a)-21(d)(2) must be given the effect of law and that these Regulations require that the grantors of these trusts be treated as owners.

Exhibits

The exhibits of all parties below listed were produced and marked and may be received in evidence

if otherwise admissible without further authentication, it being admitted that each is what it purports to be.

Plaintiffs' Exhibits

Exhibit

No.

Description

- 1—Trust Agreement dated February 11, 1952, between Max J. Kuney Jr. and Constance K. Kuney as grantors, and Max J. Kuney, as Trustee.
- 2—Trust Agreement dated February 11, 1952, between Max J. Kuney as grantor, and Max J. Kuney, Jr., as Trustee.
- 3—1952 Federal gift tax return of Max J. Kuney, Jr.
- 4—1952 Federal gift tax return of Constance K. Kuney.
- 5—1952 Washington state gift tax return of Max J. Kuney, Jr.
- 6—1952 Washington state gift tax return of Constance K. Kuney.
- 7—1952 Federal gift tax return of Max J. Kuney, Sr.
- 8—1952 Washington state gift tax return of Max J. Kuney, Sr.
- 9—Original 1952 partnership income tax return of Max J. Kuney Company.
- 10—Amended 1952 partnership income tax return of Max J. Kuney Company.
- 11—Original 1953 partnership income tax return of Max J. Kuney Company.

Exhibit

No.	Description
12—	Amended 1953 partnership income tax return of Max J. Kuney Company.
13—	1954 partnership income tax return of Max J. Kuney Company.
14—	1952 fiduciary income tax return of Max J. Kuney, Jr., as trustee of John R. Kuney.
15—	1953 fiduciary income tax return of Max J. Kuney, Jr., as trustee for John R. Kuney.
16—	1954 fiduciary income tax return of Max J. Kuney, Jr., as trustee for John R. Kuney.
17—	1952 income tax return of Max J. Kuney, Sr., as trustee for Caroline I. Kuney.
18—	1953 fiduciary income tax return of Max J. Kuney, Sr., as trustee for Caroline I. Kuney.
19—	1954 fiduciary income tax return of Max J. Kuney, Sr., as trustee for Caroline I. Kuney.
20—	1952 fiduciary income tax return of Max J. Kuney, Sr., as trustee for Max J. Kuney, III.
21—	1953 fiduciary income tax return of Max J. Kuney, Sr., as trustee for Max J. Kuney, III.
22—	1954 fiduciary income tax return of Max J. Kuney, Sr., as trustee for Max J. Kuney, III.
23—	General ledger journal voucher No. 877 of books of account of Max J. Kuney Company.
24—	Agreement dated February 11, 1952, between Max J. Kuney, Sr. and Max J. Kuney, Jr., as Trustee, with respect to division of profits.

Exhibit

No.	Description
25—	Agreement dated February 11, 1952, between Max J. Kuney, Jr. and Max J. Kuney, Sr., as trustee, with respect to division of profits.
26—	Letter from Max J. Kuney, Sr., as trustee, to Max J. Kuney, Jr., dated December 3, 1952, re distribution of trust income.
27—	Letter from Max J. Kuney, Sr., trustee, to Max J. Kuney, Jr., dated December 22, 1952, re distribution of trust income.
28—	Letter from Max J. Kuney, Jr., to Inheritance Tax Division, Washington State Tax Commission, dated April 7, 1953.
29—	Letter from Max J. Kuney, Jr., to Inheritance Tax Division, Washington State Tax Commission, dated August 7, 1953.
30—	Financial statements of Max J. Kuney Company for year ended December 31, 1952.
31—	Financial statements of Max J. Kuney Company for year ended December 31, 1953.
32—	Financial statements of Max J. Kuney Company for year ended December 31, 1954.
33—	Rental Agreement dated May 14, 1953, between Max J. Kuney Company, a partnership, and Max J. Kuney Company, a corporation.
34—	Certified copy of Certificate of Firm Name filed by Max J. Kuney Company, dated July 2, 1945.
35—	Certified copy of Certificate of Firm Name filed by Max J. Kuney Company, dated March 27, 1953.

Exhibit

No.

Description

- 36—Letter of May 1, 1956, and attachments to Dun & Bradstreet, Inc.
- 37—Company books and records.
- 38—1955 partnership tax returns thru 1959.
- 39—1953 thru 1959 Max Kuney Co. (Inc.) corporate tax returns.

Stipulation

It Is Hereby Stipulated between the parties that if the jury finds for the plaintiff as to any of the years in controversy, the parties will submit computations to the Court of the tax refunds due the plaintiff on the basis that after the payment of reasonable salaries to Max J. Kuney, Sr., and Max J. Kuney, Jr., the remaining net profits of the partnership were to be divided among the partners as follows:

A. One-half thereof to be paid to Max J. Kuney, Sr., and to Max J. Kuney, Jr., as Trustee for John R. Kuney, to be divided between said two partners in the same ratio as their two capital accounts bore to each other on January 1st of each year; and

B. One-half thereof to be paid to Max J. Kuney, Jr., and to Max J. Kuney, Sr., as Trustee for Max J. Kuney III and Caroline I. Kuney, to be divided between said two partners in the same ratio as their two capital accounts bore to each other on January 1st of each year.

Action by the Court

The Court has ruled that the above-entitled actions shall be consolidated for trial before a jury.

The foregoing pre-trial order has been approved by the parties hereto, as evidenced by the signatures of their counsel hereon, and this order is hereby entered, as a result of which the pleadings pass out of the case, and this pre-trial order may be amended only by order of the Court pursuant to agreement of the parties upon reasonable notice or to prevent manifest injustice.

Dated this 4th day of November, 1960.

/s/ GEORGE H. BOLDT,

United States District Judge.

Form Approved:

/s/ ALLAN H. TOOLE,

Attorney for Plaintiffs.

/s/ DALE E. ANDERSON,

Attorney for Defendant.

[Endorsed]: Filed November 7, 1960.

[Title of District Court and Cause.]

Civil No. 4990, 4991, and 4992

MOTION FOR DIRECTED VERDICT

The defendant, William E. Frank, by his attorney, moves this Court to grant defendant a directed verdict for the following reasons:

1. Sections 167 of the 1939 Code and 677 of the 1954 Code provide that a grantor of a trust shall

be treated as owner of the trust if the trust income may be distributed to the grantor without the approval or consent of any adverse party, "Nowhere in Sections 167 [1939 Code] or 677 [1954 Code] is there any suggestion that the * * * trust income must actually be distributed to the grantor in order to make the section applicable." *Kent v. Rothensies*, 120 F. 2d 476, 479 (C.A. 3d). This statute is not one of the so-called "Clifford" statutes since it has been in the law since 1924 and states the law independently of the Clifford rules. Here the statute says the grantor "shall be treated as owner" if the above-mentioned conditions are present. Applicability of this statute is not restricted to cases where the grantor is in substance and for practical purposes the owner of the trust corpus even though not technically so. The grantor is treated as owner simply because he created this kind of a trust, without regard to the conduct of the trust. Taxpayer has failed to show that the statute is not applicable.

2. The only exception which could abate the force of the statute upon the trusts in these cases was not shown to be applicable.

(a) The trustee was not an adverse party.

(b) The trust income could be distributed to the grantor during the minority of the children.

(c) The children were minors at all times pertinent hereto.

(d) The income could be used for the support or maintenance of the grantor's children who he was legally obligated to support.

(e) The grantor of each trust was not a trustee as to his own children. (See (g) and (h) below.)

(f) The grantor had the right to apply the trust income distributed by the trustee in any way he saw fit for the maintenance, education, enjoyment, health, and welfare, of his children.

(g) Revised Code of Washington provides:

Section 26.16.140 Earnings of wife and minor children living apart. The earnings and accumulations of the wife and of her minor children living with her, or in her custody while she is living separate from her husband, are the separate property of the wife.

and Section

26.16.125 Custody of children. Henceforth the rights and responsibilities of the parents in the absence of misconduct shall be equal, and the mother shall be as fully entitled to the custody, control and earnings of the children as the father, and in case of the father's death, the mother shall come into as full and complete control of the children and their estate as the father does in case of the mother's death.

These statutes are clear in providing that a parent does own the income of his child. A parent is obviously not a trustee of his children's income.

(h) If a parent were a trustee he would be governed by the Trustee's Accounting Act—Chapter 30.30 of RCW. This Act, Section 30.30.030 provides:

Intermediate and final accounts—Contents—Filing. In addition thereto any such trustee or trustees whenever it or they so desire, may file in the superior court of the county in which the trustees or one of the trustees resides an intermediate account under oath showing:

- (1) The period covered by the account;
- (2) The total principal with which the trustee is chargeable according to the last preceding account or the inventory if there is no preceding account;
- (3) An itemized statement of all principal funds received and disbursed during such period;
- (4) An itemized statement of all income received and disbursed during such period, unless waived;
- (5) The balance of such principal and income remaining at the close of such period and how invested;
- (6) The names and addresses of all living beneficiaries, including contingent beneficiaries, of the trust, and a statement as to any such beneficiary known to be under legal disability;
- (7) A description of any possible unborn or unascertained beneficiary and his interest in the trust fund.

In addition thereto, after the time for termination of the trust shall have arrived, the trustee or trustees may file a final account in similar manner.

30.30.020 Trustee's annual statement. The trustee or trustees appointed by any will, deed or agreement heretofore or hereafter executed shall mail or deliver at least annually to each adult income trust beneficiary a written itemized statement of all current receipts and disbursements made by the trustee of the funds of the trust both principal and income, and upon the request of any such beneficiary shall furnish him an itemized statement of all property then held by such trustee, and may also file any such statement in the superior court of the county in which the trustee or one of the trustees resides.

No such statements were in fact prepared or sent.

(i) A parent is not a legal guardian of a child unless so appointed by a court. Therefore, these parents are not excused by Section 30.30.010 from making such a report if they are in fact trustees over the property of their own children. Section 30.30.010 excuses, e.g., executors, administrators or guardians from the trust reporting requirements. These parents were never appointed as legal guardians over their children and were hence not controlled by the laws relating to guardians.

(j) The possibility that the grantor-parent could receive this income which could be used to satisfy his legal obligation to support his children (where as parent he has this power not as a trustee) makes the trust income taxable to him as owner.

The foregoing is supported both by the evidence adduced the terms of the statute and by the committee reports establishing the exception (S. Rep.

No. 627, 78th Cong., 1st Sess., p. 68 (1944 Cum. Bull. 973, 1023). The exception:

* * * is not applicable if discretion to apply or distribute the trust income for support, maintenance, or education rests solely in the grantor or in the grantor in conjunction with other persons unless the grantor has such discretion as trustee.

3. Plaintiffs have failed to produce evidence that they are entitled to a refund since they have not shown that Treasury Regulations 118, Section 39.22 (a)-21(d) (2) (iii) are not applicable for the years 1952 and 1953. They have also failed to produce evidence that Section 674 of the 1954 Code does not require that they be treated as the owners of the trusts.

4. Plaintiffs have failed to produce evidence that the trusts qualified as partners in the family partnership since there was an absence of the passage of the requisite ownership of property from the grantors to the trust. Stated otherwise, the grantor's of these trusts retained too many of the incidents of ownership to allow the trusts to qualify as bona fide partners in this family partnership.

5. Plaintiffs have failed to produce evidence that they are entitled to a refund for any reason.

/s/ CHARLES P. MORIARTY,
United States Attorney,
Attorney for Defendant.

[Endorsed]: Filed November 22, 1960.

[Title of District Court and Cause.]

Civil No. 4990, 4991 and 4992

RENEWAL OF DEFENDANT'S MOTION
FOR A DIRECTED VERDICT

Now comes the defendant, by his attorney, at the close of the introduction of all of the evidence in the trial of this case and renews his motion for a directed verdict and for judgment for the defendant made at the close of the introduction of the evidence for plaintiff, defendant again moves the Court to instruct and direct the jury to find and return a verdict for the defendant and to enter judgment for the defendant dismissing the Complaint upon the same grounds which were stated in his original motion.

/s/ CHARLES P. MORIARTY,
United States Attorney,
Attorney for Defendant.

[Endorsed]: Filed November 22, 1960.

[Title of District Court and Cause.]

Civil No. 4990, 4991 and 4992

VERDICT

We, the Jury in the Above-Entitled Causes,
Find as Below Stated:

On a consideration of all facts and circumstances shown by the evidence and under the law given you

by the Court, do you find the status of Kuney Sr. and Kuney Jr. in their trustee capacity (separate and apart from their personal capacity) as partners in the Kuney family partnership genuine, bona fide and valid for income tax purposes?

Answer yes or no.

Yes.

Dated: 11/23/60.

/s/ ALFRED W. CLARKE, JR.,
Foreman.

[Endorsed]: Filed November 23, 1960.

[Title of District Court and Cause.]

Civil No. 4990, 4991 and 4992

DEFENDANT'S MOTION FOR JUDGMENT
NOTWITHSTANDING THE JURY'S VER-
DICT AND THE ALTERNATIVE FOR A
NEW TRIAL PURSUANT TO RULES
50(b) AND 59 OF THE FEDERAL RULES
OF CIVIL PROCEDURE.

Defendant, William E. Frank, moves this Court, pursuant to Rules 50(b) and 59 of The Federal Rules of Civil Procedure, and Rule 48 of the Local Rules, Western District of Washington, to have the verdict set aside and judgment entered in accordance with his motion for a directed verdict

and in the alternative for a new trial on the following grounds:

I.

1. Defendant is, as a matter of law, entitled to judgment even if the trusts are properly held to be bona fide partners for tax purposes. The sole and only question presented to the jury was the bona fides of the trustees as partners. The jury's verdict on that question is believed to be clearly erroneous as set forth under II below. However, as was pointed out in defendant's memorandum in support of his motion for summary judgment, the question still remains in this case as to whether the grantors of the trusts are, for practical purposes, the owners of the trust corpus and income even though not technically such owners.

The defendant relies principally on §167 of the 1939 Code and §677 of the 1954 Code as entitling him to judgment non obstante veredicto as set forth in his motion for a directed verdict filed at the conclusion of plaintiff's evidence.

The terms of §677 of the 1954 Code (which will be referred to here rather than §167 of the 1939 Code, as both are substantially the same) are entirely satisfied and should be applied. This section is not one of the so-called Clifford statutes as it has been in the law since 1924. Its provisions are not simple, but upon consideration are clearly applicable to the facts of this case.

(i) The trustee of each trust is not an adverse party, as that term is defined in §672(a) of the

1954 Code. To be an adverse party the trustee would have to hold a beneficial interest in the trust property itself so that he would be adversely affected in his own right if he should elect to pay out trust funds to the grantor of the trust. There is no dispute in this case concerning the fact that the trustees are non-adverse parties.

(ii) The income of the trusts may be distributed to the grantors of the trusts per the provisions of the trust instrument (Ex. 1, p. 5).

(iii) The exception to the general rule of §677(a) is not applicable here because the parent, grantors of the trusts are not trustees as to their own children. They were never appointed as guardians and are not required to exercise the care of a fiduciary in dealing with funds for the maintenance, education, enjoyment, health and welfare of their own children. Washington Revised Code, §26.16.125, provides that the parent is entitled to custody and control over the property or earnings of his children. Unless he is a trustee, he may use such property as he deems to his own best interest without possibility of judicial review.

The trust instrument specifically absolves the trustee from judicial review of his actions (Ex. 1, p. 3) and absolves him from all responsibility for the application of the funds paid over to the guardian or parent of the children (who were in all cases the grantors of the trusts) (Ex. 1, p. 5).

(iv) The exception to the general rule of §677 clearly does not apply to this case as was spelled out by the Congressional Reports relating to this exception (S. Rep. No. 627, 78th Cong., 1st Session, p. 68) (1944 Cum. Bull. 973, 1023); the exception:

“* * * is not applicable if discretion to apply or distribute the trust income for support, maintenance, or education rests solely in the grantor or in the grantor in conjunction with other persons unless the grantor has such discretion as trustee.” (Emphasis added.)

It will be a strange new rule of law in this State if it is determined that a parent is a trustee over property held for the benefit of his children even when he is not appointed as such by a judicial tribunal or is so designated by the instrument which transfers the right to receive the property to the parent in the first place.

2. Although §677 of the 1954 Code is not a so-called Clifford statute, the applicable statutes and the rationale of the Clifford case, 309 U.S. 31 (1940) does entitle the defendant to judgment non obstante veredicto because the trustor was shown by all the facts and circumstances relating to the grant and conduct of the trust to be in substance and for practical purposes the owner of the trust corpus even though not technically so.

The question of practical ownership was not put to the jury, and is a matter of law, on consideration

of the facts and circumstances to be considered by the Court after it is determined that the trustees were bona fide partners in the partnership. If they were not so found, this present question would be entirely moot.

This issue was not conceded by the defendant at any time and is preserved as a legal issue in the pre-trial order (p. 11) under issue of law No. 1.

II.

1. There was an insufficiency of the evidence to justify the verdict.

2. The verdict was contrary to the evidence and to the clear weight of the evidence.

3. The evidence did not establish facts sufficient to prove the plaintiffs' cause of action or to justify the verdict in favor of the plaintiffs.

A. The evidence proved beyond any reasonable doubt that there was a direct retention of control by the grantors of the trusts over:

(i) Income distribution.

(ii) Assets essential to the partnership business.

(iii) Trust corpus and accumulated income.

(iv) Management powers over salaries, allocation of shares of income, investments to be used in the partnership business or in related businesses, business to be done by the partnership, income to be earned by the partnership by control over the

sole source of income to the partnership, e.g., rental charges to be paid for the rental of equipment used by the grantors in a construction business in which the trusts had no interest.

(v) Sale or liquidation of the trusts' interests.

B. There were direct controls by the grantors over actions of other trustee partners since no partner has a right to act without consulting the other partners. Revised Code of Washington, §25.04.240 gives each partner the "right to participate in the management" of the business.

C. There were in addition to the direct controls mentioned in (B) supra indirect controls which were exercised by the donors through:

(i) A separate business organization — the Kuney Co. corporation in which only the grantors held interests and which rented all the partnership's fixed assets and performed the construction contracts.

(ii) Joint crossed trusts by virtue of which each donor had the power to control the funds of his trustee. Any action contrary to the grantors' wishes were subject to reciprocal action by the grantor against the trustee's own trust.

(iii) By familial relationship since both grantors and trustees were, partners and father and son.

D. Income was distributed to the trusts by book entry only and was entirely controlled by the re-

spective grantors without possibility of judicial review. (Ex. 1, p. 3) (trust instrument.) The shares of income were subject to adjustment by the grantors and was in fact adjusted by the grantors without benefit of any disinterested judgment.

E. After income was distributed by book entry its investment, withdrawal, loan to business controlled and owned by grantors was entirely at the discretion of the grantors. There was no restriction in any trust or partnership agreement which would impose any restriction whatever on the grantors of the trusts in the use or distribution of the funds.

F. There was no recognition of trusts as partners in complying with local partnership, fictitious names and business registration statutes, even though compliance with the statute was made, as to the grantor partners, in 1945 (Ex. 34) and in 1953 (Ex. 35). The last document filed was over a year after the creation of the trusts with no mention whatever of trusts being partners.

G. The partnership agreements (Exs. 24 and 25) do not establish the trusts as partners in the partnership business but merely give the trusts the right to receive a distribution of "total Max J. Kuney income." No agreement as to the trust being a partner in the partnership business was ever entered into.

H. The only written agreements, records, or memoranda ever filed were for tax purposes without

any corresponding recognition for business purposes of the trusts as partners, subject to the rights, obligations and privileges of partners.

III.

In the event the requests under paragraphs I and II are not granted, the defendant requests a new trial to resolve any disputed questions of fact or law or to permit a verdict to be entered in conformity with the facts of the case. Defendant further requests opportunity for filing briefs. Brief to be filed within 30 days from receipt of transcript of proceedings.

/s/ CHARLES P. MORIARTY,
United States Attorney.

/s/ DALE E. ANDERSON,
Trial Attorney, Dept. of
Justice.

Certificate of service by mail attached.

[Endorsed]: Filed November 25, 1960.

United States District Court, Western District of
Washington, Northern Division

Civil No. 4990

MAX J. KUNEY, JR., and CONSTANCE K.
KUNEY, Husband and Wife,

Plaintiffs,

vs.

WILLIAM E. FRANK,

Defendant.

Civil No. 4991

MAX J. KUNEY, SR.,

Plaintiff,

vs.

WILLIAM E. FRANK,

Defendant.

Civil No. 4992

OLIVE R. KUNEY,

Plaintiff,

vs.

WILLIAM E. FRANK,

Defendant.

JUDGMENT NOTWITHSTANDING THE
VERDICT OF THE JURY

The above-entitled action having come on for trial before this Court on November 23, 1960, with jury, the plaintiffs and defendant appearing by their respective attorneys, the jury having rendered

a verdict in favor of the plaintiffs and defendant having filed a motion for judgment notwithstanding the verdict on November 25, 1960 and upon consideration of the stipulation of facts in the pre-trial order, the exhibits, the briefs, and oral arguments of the parties, and the entire record, and the Court having rendered its decision on defendant's motion on March 22, 1961, which decision is made a part hereof by reference, it is hereby

Ordered, Adjudged and Decreed that plaintiffs are not entitled to any recovery prayed for in the complaints and defendant's motion for judgment notwithstanding the verdict rendered by the jury having been granted, judgment is hereby entered for the defendant dismissing plaintiffs' complaints, with prejudice, and with costs, if any, to be assessed against plaintiffs.

Done in Open Court this 24th day of April, 1961.

/s/ GEORGE H. BOLDT,
United States District Judge.

Approved as to form:

/s/ JOSEPH C. McKINNON,
Assistant U. S. Attorney.

Copy received and Notice of Presentment waived.

/s/ E. GLENN HARMON,
Of Attorneys for Plaintiffs.

[Endorsed]: Filed April 24, 1961.

Entered: April 25, 1961.

[Title of District Court and Cause.]

Civil No. 4990

NOTICE OF APPEAL

Notice Is Hereby Given that Max J. Kuney, Jr., and Constance K. Kuney, husband and wife, plaintiffs above named, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the judgment of dismissal entered March 22, 1961, on granting defendant's motion for Judgment Notwithstanding the Verdict of the Jury, and from the Judgment Notwithstanding the Verdict of the Jury entered on the civil docket on April 25, 1961.

Dated this 17th day of May, 1961.

/s/ ALLAN H. TOOLE,

/s/ E. GLENN HARMON,

WITHERSPOON, KELLEY,
DAVENPORT & TOOLE,
Attorneys for Plaintiffs.

[Endorsed]: Filed May 19, 1961.

[Title of District Court and Cause.]

Civil No. 4991

NOTICE OF APPEAL

Notice Is Hereby Given that Max J. Kuney, Sr., plaintiff above named, hereby appeals to the United

States Court of Appeals for the Ninth Circuit from the judgment of dismissal entered March 22, 1961, on granting defendant's motion for Judgment Notwithstanding the Verdict of the Jury, and from the Judgment Notwithstanding the Verdict of the Jury entered on the civil docket on April 25, 1961.

Dated this 17th day of May, 1961.

/s/ ALLAN H. TOOLE,

/s/ E. GLENN HARMON,

WITHERSPOON, KELLEY,
DAVENPORT & TOOLE,
Attorneys for Plaintiffs.

[Endorsed]: Filed May 19, 1961.

[Title of District Court and Cause.]

Civil No. 4992

NOTICE OF APPEAL

Notice Is Hereby Given that Olive R. Kuney, plaintiff above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the judgment of dismissal entered March 22, 1961, on granting defendant's Motion for Judgment Notwithstanding the Verdict of the Jury, and from the Judgment Notwithstanding the Verdict of the Jury entered on the civil docket on April 25, 1961.

Dated this 17th day of May, 1961.

/s/ ALLAN H. TOOLE,

/s/ E. GLENN HARMON,

WITHERSPOON, KELLEY,
DAVENPORT & TOOLE.

[Endorsed]: Filed May 19, 1961.

[Title of District Court and Cause.]

Civil No. 4990

BOND FOR COSTS ON APPEAL

Know all men by these presents:

That we, Max J. Kuney, Jr. and Constance K. Kuney, Husband and Wife, the Plaintiffs above named as Principals and the General Insurance Company of America, a corporation organized under the laws of the State of Washington, and authorized to transact the business of surety in the State of Washington, as Surety, are held and firmly bound unto William E. Frank, the defendant above named in the just and full sum of Two Hundred Fifty and no/100 (\$250.00) Dollars, for which sum, well and truly to be paid, we bind ourselves, our heirs, executors, administrators and successors, jointly and severally, firmly by these presents.

Sealed with our seals and dated this 17th day of May, A. D., 1961.

The Condition of This Obligation is Such, That,

Whereas, the above named Defendant on the 22nd day of March, A. D., 1961, in the above entitled action and court recovered judgment against the Plaintiffs above named for Judgment of Dismissal

And Whereas, the above named Principals have heretofore given due and proper notice that they appeal from said decision and judgment of said United States District Court, Western District of Washington, Northern Division to the Ninth Circuit Court of Appeals.

Now Therefore, if the said Principals, Max J. Kuney, Jr. and Constance K. Kuney, Husband and Wife shall pay to William E. Frank the Defendant above named, all costs and damages that may be awarded against him on the appeal if the appeal is dismissed or the judgment affirmed, or such costs as the appellate court may award if the judgment is modified, not exceeding the sum of Two Hundred Fifty and no/100 (\$250.00) Dollars then this obligation to be void, otherwise to remain in full force and effect.

/s/ MAX J. KUNEY, JR.,

/s/ CONSTANCE K. KUNEY.

[Seal] GENERAL INSURANCE COM-
 PANY OF AMERICA.

By /s/ THYRA NORTHLANDER,
 Attorney-in-Fact.

[Endorsed]: Filed May 19, 1961.

[Title of District Court and Cause.]

Civil No. 4991

BOND FOR COSTS ON APPEAL

Know all men by these presents:

That I, Max J. Kuney, Sr., the Plaintiff above named as Principal and the General Insurance Company of America, a corporation organized under the laws of the State of Washington, and authorized to transact the business of surety in the State of Washington, as surety, are held and firmly bound unto William E. Frank, the defendant above named in the just and full sum of Two Hundred Fifty and no/100 (\$250.00) Dollars, for which sum, well and truly to be paid, we bind ourselves, our heirs, executors, administrators and successors, jointly and severally, firmly by these presents.

Sealed with our seals and dated this 18th day of May, A. D., 1961.

The Condition of This Obligation is Such, That,

Whereas, the above-named Defendant on the 22nd day of March, A. D., 1961, in the above-entitled action and court recovered judgment against the Plaintiff above named for Judgment of Dismissal.

And Whereas, the above-named Principal has heretofore given due and proper notice that he appeals from said decision and judgment of said United States District Court, Western District of

Washington, Northern Division to the Ninth Circuit Court of Appeals.

Now Therefore, if the said Principal, Max J. Kuney, Sr., shall pay to William E. Frank the Defendant above named, all costs and damages that may be awarded against him on the appeal if the appeal is dismissed or the judgment affirmed, or such costs as the appellate court may award if the judgment is modified, not exceeding the sum of Two Hundred Fifty and No/100 (\$250.00) Dollars then this obligation to be void, otherwise to remain in full force and effect.

/s/ MAX J. KUNEY.

[Seal] GENERAL INSURANCE COMPANY OF AMERICA,

By /s/ THYRA NORTHLANDER,
Attorney-in-Fact.

[Endorsed]: Filed May 19, 1961.

[Title of District Court and Cause.]

Civil No. 4992

BOND FOR COSTS ON APPEAL

Know all men by these presents:

That I, Olive R. Kuney, the Plaintiff above named as Principal and the General Insurance Company of America, a corporation organized

under the laws of the State of Washington, and authorized to transact the business of surety in the State of Washington, as Surety, are held and firmly bound unto William E. Frank, the defendant above named, in the just and full sum of Two Hundred Fifty and no/100 (\$250.00) Dollars, for which sum, well and truly to be paid, we bind ourselves, our heirs, executors, administrators and successors, jointly and severally, firmly by these presents.

Sealed with our seals and dated this 18th day of May, A. D., 1961.

The Condition of this Obligation is Such, That,

Whereas, the above-named Defendant on the 22nd day of March, A. D., 1961, in the above-entitled action and court recovered judgment against the Plaintiff above named for Judgment of Dismissal.

And Whereas, the above-named Principal has heretofore given due and proper notice that she appeals from said decision and judgment of said United States District Court, Western District of Washington, Northern Division to the Ninth Circuit Court of Appeals.

Now Therefore, if the said Principal, Olive R. Kuney shall pay to William E. Frank, the Defendant above named, all costs and damages that may be awarded against him on the appeal if the appeal is dismissed or the judgment affirmed, or such costs as the appellate court may award if the judgment is modified, not exceeding the sum of Two Hundred Fifty and No/100 Dollars (\$250.00) then this ob-

ligation to be void, otherwise to remain in full force and effect.

/s/ OLIVE R. KUNEY,

By /s/ MAX J. KUNEY.

[Seal] GENERAL INSURANCE COM-
PANY OF AMERICA,

By /s/ **THYRA NORTHLANDER,**
Attorney-in-Fact.

[Endorsed]: Filed May 19, 1961.

[Title of District Court and Cause.]

No. 4990, 4991 and 4992

ORDER EXTENDING TIME FOR FILING RECORD ON APPEAL AND DOCKETING APPEAL

It Is Hereby Ordered by this Honorable Court that Max J. Kuney, Jr., and Constance K. Kuney, husband and wife, Max J. Kuney, Sr., and Olive R. Kuney, Plaintiffs-Appellants, shall have, pursuant to Rule 73(g) of the Federal Rules of Civil Procedure, their time extended to August 17, 1961, for filing the record on appeal and docketing the appeal.

Done in Open Court this 23rd day of June, 1961.

/s/ GEO. H. BOLDT,
United States District Judge.

Presented by:

/s/ ALLEN A. BOWDEN,
One of the Attorneys for
Plaintiffs-Appellants.

Approved:

/s/ JOSEPH C. McKINNON,
Ass't. U. S. Attorney, One of the Attorneys for
Defendant-Appellee.

[Endorsed]: Filed June 27, 1961.

In the District Court of the United States for the
Western District of Washington, Northern
Division

No. 4990

MAX J. KUNEY, JR., and CONSTANCE K.
KUNEY, Husband and Wife,
Plaintiffs,

vs.

WILLIAM E. FRANK, District Director of In-
ternal Revenue,
Defendant.

No. 4991

MAX J. KUNEY, SR.,
Plaintiff,

vs.

WILLIAM E. FRANK, District Director of In-
ternal Revenue,
Defendant.

No. 4992

OLIVE R. KUNEY,

Plaintiff,

vs.

WILLIAM E. FRANK, District Director of Internal Revenue,

Defendant.

TRANSCRIPT OF PROCEEDINGS

Transcript of Proceedings had in the above-entitled and numbered cause in the above-entitled court before the Honorable George H. Boldt, United States District Judge, commencing on Monday, November 21, 1960, at the United States Courthouse, Seattle, Washington.

Appearances:

On behalf of the Plaintiffs:

MR. ALLAN TOOLE, and
MR. GLENN HARMON,
WITHERSPOON, KELLEY,
DAVENPORT & TOOLE,
Attorneys at Law.

On behalf of the Defendant:

MR. ARTHUR L. BIGGINS, and
MR. DALE E. ANDERSON,
Attorneys, Tax Division, Department
of Justice, Washington, D. C.

(Whereupon, on Monday, November 21, 1960, at the hour of 9:30 o'clock a.m., all counsel heretofore noted being present, the following proceedings were had, to wit:)

(Whereupon, a jury was duly empaneled.)

(Whereupon, the admitted facts of the pretrial order were read aloud by the Court to the jury.)

(Whereupon, opening statements of counsel were rendered.)

(Whereupon, a noon recess was taken.)

Afternoon Session

The Court: Every one is here. Call a witness, please.

Mr. Toole: The plaintiff will call Mr. Kuney.

MAX JEFFREY KUNEY, SR.

plaintiff herein, called as a witness on his own behalf, being first duly sworn, was examined and testified as follows:

The Clerk: Would you state your name?

The Witness: My full name is Max Jeffrey [3*] Kuney, Sr.

Direct Examination

By Mr. Toole:

Q. And where do you reside?

A. At 1268 Mercer Street, Seattle.

Q. When were you born, Mr. Kuney?

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Testimony of Max Jeffrey Kuney, Sr.)

A. August 12, 1894.

Q. Where was that?

A. On a farm out of—near Wasco, Oregon.

Q. Wasco, Oregon. What is your educational background, Mr. Kuney?

A. Well, I started to school when I was about nine. My mother taught me to read, and I went to high school in Salem, left school when I was fifteen years old and went to Alaska. Except for going back to high school for two years later and finishing, which I did do, why, that is my formal schooling.

Q. What kind of work, Mr. Kuney, were you engaged in after you got out of high school?

A. Well, I continued to do—I worked on the survey parties.

Q. Did you have any formal engineering training, experience? A. No.

Q. In your work?

A. But I became a civil engineer. [4]

Q. Could you speak up so that the jury can hear you?

A. I was a professional engineer for—except for a year when I was—became bookkeeper for a construction firm.

Q. What experience did you have in the general contracting business prior to 1939?

A. Well, I became—I went into the general contracting business actively in 1924, or shortly thereafter. In 1924 I went to work for a general contractor as a bookkeeper.

Q. What does a general contractor do?

(Testimony of Max Jeffrey Kuney, Sr.)

A. He contracts in general and takes a general contract, and that is just a separation from the subcontractor who usually takes a contract from a general contractor.

Q. Was most of this experience in roads and heavy construction, things of that sort?

A. Railroads entirely until 19—as a civil engineer always on railroads until 1919 and thereafter on highways, and at first as a contractor on railroad construction, Southern Pacific.

Q. When were you married to Lorraine Kuney?

A. In August, 1916, when I was twenty-two.

Q. Were there any children born of that marriage? A. Yes, Max Kuney, Jr.

Q. Any other children?

A. No others born of that marriage. [5]

Q. That was Lorraine Kuney? A. Yes.

Q. When were you separated from Lorraine Kuney? A. In about 1942, as I recall it.

Q. You married Olive Kuney. When was that?

A. In 1944.

Q. Were any children born of that marriage?

A. Yes, John in 1945.

Q. Any other children? A. No others.

Q. Directing your attention back to the year 1939, how old was your son, Max, Jr., at that time?

A. Twenty-one, I believe.

Q. Had he had any contracting experience prior to that time? A. No.

Q. What prompted you to consider taking him into business with you at that time?

(Testimony of Max Jeffrey Kuney, Sr.)

A. To make a family business.

Q. You were engaged in the general contracting business at that time as a sole proprietor?

A. With two special partners.

Q. Who were those two special partners?

A. They were—there were three special partners, M. F. Coons, Lloyd Reed, [6] R. T. McAndrews.

Q. Did Max Kuney, Jr., go into any—Strike that.

How did you take Max, Jr., into the business? What arrangement did you make with him?

A. The arrangement with him was that effective, I believe it was in 1940, he was to share any profits equally with me wherever they would be and whatever I get.

Q. Did he put any money into the business?

A. No, he had no money.

Q. Did you have an investment in the business at that time? A. Yes.

Q. And you agreed that you would share profits equally even though you were the only one who had an investment in the business?

A. That is right.

Q. What was the name of that partnership between you and your son?

A. Max J. Kuney Company, and the name has never changed.

Q. Max J. Kuney Company? A. Yes.

Q. What was the nature of your business from the period of 1939 to the end of 1951? Tell the jury

(Testimony of Max Jeffrey Kuney, Sr.)

generally what kind of work you and your partner Max, Jr., engaged in?

A. From 1939 to 1944 it was just in Spokane. In 1944 I came to Seattle and got very active and formed the Agutter Electric Company, the Kuney-Johnson Company, the Techler Aluminum Products. [7]

Q. What did Agutter Electric Company do?

A. They were electrical contractors.

Q. What does electrical contracting mean?

A. That means that they themselves did heavy industrial type of electrical work and electrical installations on larger buildings, not residences, and also at the beginning they were an old established firm, and they had quite a trade in just little things like putting in light bulbs and service calls, one hour, but that we stopped.

Q. Who was the other person with whom you were in partnership at Agutter Electric?

A. Well, he was an employee of the old firm. I took over the firm name and the man's name was Greene, C. S. Greene.

Q. Now, was C. S. Greene a partner of Max J. Kuney Company? A. Yes, he was.

Q. Or was there a subpartnership?

A. Well, as I stated, my original agreement with my son is that we would always share equally in whatever I did do. So when I say I formed a partnership, that means that Max, Jr., and I together formed the partnership with this man Greene, who would be the operating partner. We always fur-

(Testimony of Max Jeffrey Kuney, Sr.)

nished all of the money. Greene also had no capital investment. Neither did Johnson have any [8] capital investment. I never had a partner with a capital investment. To begin with——

Q. What was Kuney-Johnson Company?

A. That was the building contractor, and the type of work they did was always not residences, it was larger buildings such as the Public Safety Building.

Q. The Public Safety Building where?

A. In Seattle, and the Federal Reserve Bank.

Q. In Seattle? A. In Seattle.

Q. Who was the partner?

A. He was Lloyd Johnson, Lloyd W. Johnson.

Q. Is it or is it not correct to say that Max J. Kuney Company was one of the partners of Kuney-Johnson, and Lloyd Johnson was the other partner, is that it?

A. Yes, that would be correct to say. It would be equally correct to say that Max Kuney, Sr., and Jr., and Lloyd Johnson were, but we always considered the Max J. Kuney Company partnership as a pair.

Q. Max J. Kuney Company was the partner of Lloyd Johnson? A. Yes.

Q. And in the third business, Techler Aluminum Products? A. Yes.

Q. Would you tell the jury what kind of business that was?

A. That was a manufacturing business and also a sales [9] business. We made aluminum window

(Testimony of Max Jeffrey Kuney, Sr.)

sash and doors and store fronts, also for industrial type buildings principally here and elsewhere, in San Francisco, as far into the Pacific as Guam, and so on.

Q. Who was the other person interested in that particular venture?

A. Well, there again it was a special partner. His name was W. H. Page. But except for the special partner, this was the same ownership as Kuney-Johnson, that is, Max J. Kuney Company, meaning Junior and I again with Lloyd Johnson. Those were the proprietors of Techler Aluminum Products.

Q. Max J. Kuney Company was one of the partners, and Lloyd Johnson was the other at Techler Aluminum Company, is that correct?

A. Yes. And also another one which I noticed not mentioned on the chart was Aralco, and the meaning is "Architectural Aluminum Company." But we went under the name of Aralco. It operated in Seattle and San Francisco.

Q. Could you tell the jury in simple terms how, for example, the profit that Agutter owned were divided as to Mr. Greene and Max J. Kuney Company?

A. After its early organization they were divided equally, fifty-fifty, the same as with Lloyd Johnson. When there would be a special partner, he would receive a [10] distribution first, and the remainder would be divided fifty-fifty, equally, I mean.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. But that is after the interest of persons who might be—Strike that.

A special partner—is it true or not true that a special partner is a person interested in a special part of the work?

A. He could be interested in only one phase of it. But in relation to Techler Aluminum and others like that, he would be a special partner for this reason, that he would not be interested in fixed assets. So that if he would leave at any time, and, of course, if he was not—if he ever became not an employee, he was no longer a partner. He could only be a partner as long as he was an employee. That was to facilitate settlement with him. There was nothing to consider, whatever. It was just always what the tax returns said that he was—that was always the basis of settlement.

Q. But after the special partners had received their share of the profits, you testified that the remaining profits are divided equally between Max J. Kuney Company and—

A. (Interposing): Yes.

Q. (Continuing): —operating partner in all of them? A. Yes.

Q. So that it is proper to say, then, that Max J. Kuney [11] Company shared half of the net profits of these subpartnerships you are talking about?

A. Yes, after the special partner got usually a minor interest.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. What kind of work was Max J. Kuney Company doing at the end of 1951?

A. Its own operation was as a heavy construction contractor.

Q. What do you mean by heavy construction?

A. Meaning that he used heavy equipment to do grading, rock crushing, paving, principally on highways or on dams, not building construction.

Q. Mr. Kuney, do you recall approximately what the partnership of Max J. Kuney Company was worth on December 31 of 1951?

A. Well, yes, I know now it was—my capital interest was \$594,000, in round numbers. Max, Junior's, was \$485,000.

Q. In round figures? A. Yes.

Q. Mr. Kuney, what considerations have you ever given to making the transfer of any part of your interest in the partnership to any of—I am referring to the end of 1951—what consideration had you given to transferring part of your partnership interest to anyone else?

Q. Well, in 1951, the latter part of 1951, some time or another, I read in a report of the American Research Institute, it was just headlined, I noticed it at a [12] glance, I heard a great deal, and the headline said, "Family Partnerships Sanctified for Tax Purposes," and that had a meaning to me, and I read right down through it.

This article stated that Congress had finally legislated and established possibly the rule——

(Testimony of Max Jeffrey Kuney, Sr.)

The Court: You had better not recite it. It was just an article of that kind.

A. (Continuing): But at that time I noticed there was a couple of requirements, and I went right about it to attend to those.

Q. (By Mr. Toole): What step did you take to make that thought into a reality?

A. Well, I was familiar with everything except one thing, and I never had any experience with trusts. So I think right in a day or two I went down to the office of Mr. Tracy Griffin, who was then alive, and told him that I was planning on setting up a trust for John. He knew who John was, and I would like to see some trust agreements if he had one, possibly one he had made up, and another one if he had them, or could he get me one that had been made by some bank, and he did so in the course of a minute or two, and I took them out in the library and read them both at the same time, and then I went down through them, and they were both quite long, [13] and that was that, and I thought I knew what they were and I thought that was all right. Then I just in my mind——

Q. Who was Mr. Tracy Griffin?

A. I just reduced it to just a sentence to what my feeling of what a trust meant.

Q. Who was Mr. Tracy Griffin?

A. He was an attorney here at that time, sir.

Q. When did you make or come to the conclusion that you wished to make a gift?

A. Well, right then. I thought, "Well, this is

(Testimony of Max Jeffrey Kuney, Sr.)

all right. There is no difficulty here that can't be straightened around, no complications." I wanted to do it.

Q. Why did you want to do it?

A. Well, particularly so because at that time—I thought it was the thing that you could do. I was, of course, aware of troubles that others had had with family partnerships, and I wanted no part of it and had no part of it, but I noticed that, and I said, "Well, this is the thing for me to do," particularly so because of my age.

Q. Was there any motive besides tax considerations that prompted you to make that?

A. Most assuredly. I knew the tax considerations, but the real thing was this, that I was then 58 and I wanted to do the same for John that I had done for Max. But I didn't know whether I would be around.

Q. How old was Johnnie at that time?

A. Six—five.

Q. Did you or did you not have any thoughts that perhaps he would be ever interested in the business?

A. Well, I wanted, above all, that he would be identified particularly with Max as his half brother and would sort of be tied to him and grow up with him.

Q. If you wished to make a gift to Johnnie, couldn't you have given him something other than an interest in the partnership?

A. Most assuredly, but the interest in the part-

(Testimony of Max Jeffrey Kuney, Sr.)

nership was the important thing. It was the thing—not that he would ever have to do it, but with the hope that as he grew up, became a year or two older, that that would incline him to continue and carry on.

Q. Did you have any property from which the gift might have been made besides an interest in the partnership?

A. I never had anything except what was in the companies and don't today.

Q. Didn't you have any securities that you might have given to him?

A. I haven't ever had any securities, anything except what was in the company since 1927, and I don't have now. [15]

Q. You stated that you, if I am correct, that Mr. Tracy Griffin let you examine some forms of trust instruments?

A. Well, his secretary just gave them—that was the end of it. Mr. Griffin talked to me maybe a half a minute. That was my purpose. I wanted to read the trust agreement, and that is where I went to do it and saw what they were.

Q. Did you ever consider making a gift outright to six-year-old Johnnie?

A. Well, no, because, as I say, I then knew that one of the things you have to do, because the child was a minor, that there had to be a trust. Without a trust it was no—you don't have a family partnership for tax purposes, and that, naturally, of course, was the motive. But I knew there had to be

(Testimony of Max Jeffrey Kuney, Sr.)

a trust. There had to be a trust because he was a minor. That was the thing I was not familiar with, and I immediately went to find out about that.

Q. Do you know why the trust device was appropriate in this circumstance?

A. Well, it was required because he was a minor.

Q. Whom did you——

A. (Interposing): And it could be—yes, and as it was used actually, and as I see it, it could be used, it could form quite another purpose. It was something like a will, [16] you know, and you state what would be done in the future. It was quite a formal document, and I thought, “Well, that has been made and passed and done for a long time,” and I noticed that there was a lot of things in it that would be all right.

Very good. In fact, most everything I could imagine I found there in a couple of pages as far as what the trustee would do and could do.

Q. Whom did you consider appointing as trustee?

A. Well, I immediately considered that the trustee that I wanted would be Max, Jr.

Q. Why?

A. He is the other boy's brother, and that, as I say, would tie them together. That was one reason, and the second is that I had been watching Max, Jr., for eight years, and he had done quite well, and I considered that he was quite capable as a business man, at least, and he should handle those things, and also I noticed that he had a great

(Testimony of Max Jeffrey Kuney, Sr.)

affection for the younger boy, and I believe that he had the right ideas about what would be good for that boy and what would not be good for the boy under certain conditions.

I wouldn't—I knew of no one more suitable as a trustee, and I know of no one now.

Q. Did you consider appointing a bank or a trust company [17] as trustee? A. Not at all.

Q. Why not?

A. They know nothing of the child. They know nothing of my business. There is nothing personal to tie them to it. It was to completely defeat my whole purpose. It is a family partnership, and that it should be, and I could never take out of my mind the thought that that was—that there was a family partnership.

Q. At this time I would like to hand to the witness Exhibit 2, Plaintiffs' Exhibit 2.

(Whereupon, a document was handed to the witness by the Bailiff.)

Q. Mr. Kuney, would you identify Plaintiffs' Exhibit 2 for the benefit of the jury?

A. This is the trust agreement dated February 11, 1952, between Max J. Kuney, myself, and Max J. Kuney, Jr., and my son in which——

Q. Who was the grantor of that trust?

A. I am the grantor, and he is the trustee.

Q. Directing your attention to the last paragraph on Page 1, I wonder if you would read that paragraph to the jury?

(Testimony of Max Jeffrey Kuney, Sr.)

A. "It is agreed that from the capital account of Max J. Kuney, grantor, shall forthwith cause to be placed to [18] the credit of the trustee, \$100,000.00 under capital account captioned 'Max J. Kuney, Jr., trustee' on the firm books of the businesses of grantor, which said sum equals approximately twenty per cent of his interest in said businesses. The crediting of said amount to the account of the trustee shall constitute the paying over, assignment, transferring, and delivering to the trustee of said sum and the receipt of the same by the trustee."

It was there that the capital account was—capital interest was credited. There was the instruction to credit it to the books of account, to enter it and make it formal on the company books.

Q. Who prepared this instrument?

A. Your law firm, and the man that prepared it was Bill Witherspoon of Witherspoon, Kelley, Davenport & Toole of Spokane.

Q. He is my partner? A. That is right.

Q. And had you had conferences with Mr. Witherspoon regarding the terms and provisions of this instrument?

A. I have been in his office, but, as I said, I had already looked at the trust agreements and I had been in his office more than once; that is, before lately, but I don't know whether it was before or after this, but at [19] least I was in his office.

Q. Will you describe to the jury the provisions

(Testimony of Max Jeffrey Kuney, Sr.)

of the trust with respect to paying off the income and the principal for the benefit of Johnnie?

A. Well, yes. In my mind the important thing is that the trustee could, if he wished, hold the income from the beneficiary until the beneficiary was thirty years old. That was always in my mind, and it is now. I know when that date comes, that until thirty years old, why, he has the discretion to distribute income to the beneficiary, and otherwise the other provisions have meant no importance to me because I don't consider there is any action that I should take on them—important action until such time——

Q. By "other provisions" you don't or do you refer to provisions with respect of distribution of the principal of the trust? Perhaps you could describe to the jury the difference between income and principal as you conceive it?

A. Income is what you earn and the principal is what you have and hold. That is my explanation.

Q. What was the principal of the trust at the time it was created? A. \$100,000.

Q. Invested in what? [20]

A. In capital interest in the business.

Q. Now, what provisions are there in the trust with respect to distribution of that principal for the benefit of the beneficiary?

A. Distribution of the principal?

Q. Yes.

A. That is a rather far distant affair probably that I am not immediately concerned with. If John

(Testimony of Max Jeffrey Kuney, Sr.)

should die before he receives his trust estate and has no children, then it would go——

Mr. Biggins: If at any time leading questions will help, counsel, we will certainly not object.

Q. (By Mr. Toole): Thank you. Directing your attention to Section 3 of Article I on Page 2, isn't it true that at any time after John came to the age of 21 years——

A. (Interposing): Yes, sir.

Q. (Continuing): ——the principal could be distributed? A. That is true, yes.

Q. Was it mandatory that the principal be distributed?

A. No, not mandatory, nor is it mandatory that income be distributed.

Q. Until he reaches age thirty? A. Yes.

Q. After age thirty then what?

A. After thirty it must be distributed. [21]

Q. The income must be distributed?

A. Yes.

Q. Now, the principal eventually is distributed to whom if it is not distributed to Johnnie, and that is what you were testifying. If it was not distributed to Johnnie prior to Johnnie's death, what would happen to the principal?

A. If he has no children, it goes to the children of Max, Jr.

Q. If he did have children?

A. It would go to his children, and if Max, Jr., has no children—it doesn't go to me, that is all I know. It is sort of left up in the air there. If they don't have any children, I do notice that, I believe,

(Testimony of Max Jeffrey Kuney, Sr.)

I have always noticed that, just a rather remote possibility, if I were to survive John and his children, if he had any, and Max, Jr., and his children, then it doesn't say where it goes.

Q. But the important parts of the trust are that the income must be distributed after age thirty?

A. That is, yes.

Q. Now, why did you put that provision in there?

A. Well, it was put in there—I notice it was in there. I had seen it before. The impression that I got was that it was a good provision. I can see reasons why it would be a good provision. I am perfectly aware of that. [22]

Q. What reasons would those be?

A. One would be this, when this particular boy Jeff becomes twenty-one——

Q. (Interposing): We are talking about Johnnie?

A. When Johnnie becomes twenty-one, yes, then this would be up to Max, Jr., to take care of the situation. But that is his business. But I would rather say what I would do in connection with Jeff's affairs, if I may, as trustee.

Q. We are talking about the trust for the benefit of Johnnie. We will discuss trusts for the benefit of Jeff.

A. The trust for the benefit of John does contain that provision.

Q. Why did you provide in the trust that the income should not be required to be distributed to Johnnie until he was thirty years of age?

A. Well, for the very simple reason—it can be

(Testimony of Max Jeffrey Kuney, Sr.)

but it shouldn't be, and while I just never before, why, I even expressed this to Max, Jr., and I know I haven't to you, but I will do so now, and it is this, that at least I would hope—and maybe from now he will get the idea, that when John does become twenty-one, and I may be living or dead, Max, Jr., is the trustee. He can do, if he will, the same as I did by him. He can make this John a partner when he is twenty-one without any capital [23] interest whatsoever if he is able and can work. I did it before, and it worked, and also he can continue with him in this trust. While this is strictly taxes, why, it would make sort of a double entity out of the matter. John himself would be a taxpayer. John himself could be working for the company with quite a large salary as a taxpayer and at the same time earning quite an income over here on the other side as the beneficiary of a trust. Both of them are taxed at individual tax rates. The only difference is that one of them is a different exemption.

I was aware, of course, that that provision was the law then, at least, or—or allowable or had been and can be done that I found, and as I say, I have had numerous partners, none with capital interest. That has just been—except this case where the trust has a capital interest.

Q. Does the——

A. (Interposing): That is the only indication in all these years.

Q. Does the trust instrument require this capital— Strike that.

(Testimony of Max Jeffrey Kuney, Sr.)

Does the trust instrument require that the capital of this trust be invested in the partnership?

A. No. This trust instrument in short gives the trustee [24] powers, discretionary powers to do everything that I can imagine.

Q. Was it your intention that the investment be left in this partnership— Strike that.

Was it your intention to control Max, Jr., as trustee in how he should invest this property?

A. No. He is, you see, the trustee, and I would—he would outlive me normally, and so, therefore, he would naturally control this.

Q. Does the trust provide if in his discretion the investment should be removed from the family partnership and invested in other properties, that he is free to do it?

A. I am sure it does because it allows him to do everything imaginable, and it has one sentence——

Q. It does provide that, doesn't it?

A. Well, I am certain that it does, because—it says he can do these things, and besides that, he can do anything a natural man could do.

Q. When you made the trust instrument—correction— When you made the gift in trust did you prepare and file the gift tax return reflecting this gift that had been made?

A. They were prepared. All the things that we knew of that were necessary were done.

Q. Referring to Exhibits 7 and 8—directing your attention [25] to Exhibit No. 7, what is that?

(Testimony of Max Jeffrey Kuney, Sr.)

A. That is a federal gift tax return for the year 1952 reporting \$9,225 payable under this return.

Q. Was that gift tax return paid?

A. Yes, certainly.

Q. Does this gift tax return reflect the gift by you of the interest in the partnership?

A. Yes, it states exactly what it is on the back.

Q. Directing your attention to Exhibit No. 8, would you identify that for the jury?

A. That is a State of Washington gift tax return.

Q. What does that show?

A. That shows that due under this return is \$2,160.

Q. Of gift tax? A. Of gift tax.

Q. Was that gift tax paid? A. Yes.

Q. To the State of Washington?

A. To the State of Washington.

Q. Was a copy of this trust agreement furnished to the Internal Revenue Service when the gift tax return was filed—with the gift tax return?

A. It was furnished to them whenever it was required to be furnished. That I can't recall when you do these things.

Q. But a copy was furnished? [26]

A. Yes, I know that to be a fact. There is, at least, a letter written inclosing it, and certainly it was.

Q. And the Internal Revenue Service accepted the gift tax on this? A. Yes.

Q. They have never offered to refund it?

(Testimony of Max Jeffrey Kuney, Sr.)

A. I have heard nothing about that.

Q. At the same time it is true, is it not, that Max, Jr., created a trust for the benefit of these two children naming you as trustee?

A. Yes, sir. Well, I wanted to be trustee of that boy a while at least, and he did that.

Q. Directing your attention to Exhibit No. 1, would you describe that instrument to the jury?

A. Yes.

Q. Is that a trust agreement?

A. This is a trust agreement also.

Q. What is the date of that?

A. It is dated the same day as the other one.

Q. What date is that?

A. Eleven, February, 1952.

Q. Who was the grantor on that instrument?

A. The grantor is—are Junior and his wife.

Q. And who is the trustee?

A. I am the trustee. [27]

Q. That trust agreement, does it not, sets up two trusts, one for the benefit of your granddaughter Caroline?

A. True.

Q. And one for the benefit of your grandson Jeff?

A. Grandson Jeff.

Q. You call him "Jeff" so we don't have a third "Max."

A. Yes, Jeff.

Q. And what was given to you in trust to hold for the benefit of those children?

A. A \$100,000 capital interest.

Q. Whose capital interest was that?

A. A \$100,000 capital interest was theirs given to me in trust to hold for them in trust

(Testimony of Max Jeffrey Kuney, Sr.)

Q. Max gave part of his interest in the partnership? A. Oh, yes.

Q. To you in trust?

A. To me in trust for the benefit of the children.

Q. To hold for the benefit of the children?

A. Yes, sir.

Q. Were there any other beneficiaries of this trust?

A. Yes, sir. There was Max's mother and her parents.

Q. What provisions were stated in the trust with respect to distribution for the benefit of these beneficiaries? What power did you have to make distribution?

A. I was empowered to make distribution to them as I thought [28] they needed it.

Q. Distributions of income, is that correct?

A. Distributions of money, yes, income.

Q. Of income? A. Yes.

Q. Do you have the authority and power to make distributions to either the minor child, Jeff or Caroline, and to Lorraine do you mean? A. Yes.

Q. And to the Bently's.

A. That is true, yes.

Q. You have that power? A. I do.

Q. Isn't it true that the trust provides that after any distributions to Lorraine it was to be charged equally to Jeff's and Caroline's trust?

A. I am quite sure that is so, yes. I am quite sure that is so.

Q. And is it also not true that the distributions

(Testimony of Max Jeffrey Kuney, Sr.)

of capital follow the same pattern as the trust you previously discussed, that after age twenty-one you had the discretion to distribute?

A. Yes, that is so, I know. That is so, I know, yes, that I can at my discretion or any trustee can hold this income until these children are thirty years old, but he [29] don't have to do so. But he can do so.

Q. Who would be the trustee of this trust after you pass away?

A. I think Spokane Eastern, a bank, or—no, I guess—Max, Jr., becomes the trustee himself, and then the bank.

Q. Directing your attention to the top of page 11, it provides, does it not, that in the event Max Kuney——

A. (Interposing): Yes.

Q. (Continuing): ——that in the event you are unable to act as trustee, Max Kuney, Jr., would succeed as trustee?

A. Yes.

Q. If he does not wish to act, the Seattle-First National Bank then becomes trustee?

A. Yes, that is true, or in the event of his death, Seattle-First National Bank would become the trustee.

Q. Now, returning to the first trust which we were discussing, the trust which you created and appointed your son Max, Jr., trustee, you have testified that the trust instrument provided that there was to be a transfer of a capital interest in the partnership from you to Max, Jr., as trustee. Was that actually done on the books of account?

(Testimony of Max Jeffrey Kuney, Sr.)

A. Yes, that was done, yes.

Q. How was it carried out on the books of account with the [30] partnership?

A. Well, the capital account was set up in the name of the trustee, and there an entry is made, and it shows a \$100,000 there, and, of course, the appropriate account of a trust.

Q. The trust capital——

A. (Interposing): Who has given what to do? Pardon my confusion, but is this a gift to John?

Q. I am referring to the gift you made in trust to Max, Jr., for the benefit of John.

A. Well, yes, of course. That then would be charged to my personal account, and it would be set up as a credit in a capital account in the Kuney family partnership under the name of Max, Jr.—Max Kuney, Jr., trustee for the benefit.

Q. Was such an account actually set up on the books of the partnership? A. Yes.

Q. In the beginning of 1952 when this gift was made——

A. (Interposing): Well, I presume it was. It was set up the first.

Q. You have seen recently copy of the books of account, haven't you, where that account was actually created?

A. Yes, it was created. I didn't notice at the time. I am sure—yes, of course, it was done [31] in '52.

Q. Didn't all the financial statements show after that—the books show that trustee?

(Testimony of Max Jeffrey Kuney, Sr.)

A. Yes, they do show that in 1952.

Q. They have ever since the beginning of 1952?

A. Since 1952, I do know that. I have those always. But the books are in Spokane, and I am in Seattle.

Mr. Biggins: There is no dispute about that at all, your Honor. We will stipulate that, if it will help.

Q. (By Mr. Toole): Is it not true that the same thing as stipulated by Mr. Biggins was done with respect to John? A. Yes.

Q. With respect to the trust created by Max, Jr.?

A. Yes, that I do know. It is my duty to see that it was done, and I know it was done.

Q. Will you describe the nature of the partnership business as it was conducted by the partnership from the beginning of 1952 up to the formation of the corporation in the middle of 1953?

A. Yes.

Q. What kind of business were you engaged in?

A. There was no other Max J. Kuney Company, a partnership, the trust for partners. We did it all. There was no other entity. We were partners with all other firms [32] that I have mentioned under our own account operating in Seattle—in Spokane and elsewhere, and it was one entity, and the trusts were partners in that entity.

Q. And during this time were the subpartnerships with Techler Aluminum, Agutter Electric, and Kuney-Johnson Company going on as they had?

(Testimony of Max Jeffrey Kuney, Sr.)

A. Yes.

Q. In May of 1953 you determined to form a corporation, didn't you? A. Yes, then I did.

Q. Why did you determine to form a corporation?

A. That was because of two men, one in particular who was a general superintendent that had been with the business since—for many years and had accumulated \$86,000 or so, and we wanted to give him an interest and make him a real interest. He is a young man also.

Q. What is his name?

A. His name was Wigginton. It was formed for that principal business purpose.

Q. Who were the incorporators of the corporation?

A. Max and I and this fellow Peterson, who was an office manager.

Q. What name did the corporation have?

A. Max J. Kuney Company.

Q. Who owned the shares—to whom were the shares of [33] Max J. Kuney Company, a corporation, issued?

A. They were first issued to—the old Max J. Kuney Company, that was a partnership which—

Q. (Interposing): To the partners?

A. Yes, Max, Jr., and I and the trusts.

Q. What did the partnership transfer to the corporation at that time in consideration of those shares? A. Pardon me?

Q. What went into the corporation?

(Testimony of Max Jeffrey Kuney, Sr.)

A. \$400,000.

Q. Of cash? A. Well, credits.

Q. Was it accounting business and work in process and that type of thing that were turned over to the corporation as well as cash?

A. Well, they would naturally be fractionally interested, but when I make an entry of that kind, you just merely—you set up a corporation here, and there is \$400,000 capital in the thing.

Q. I am distinguishing what was left between the corporation and the partnership. What was left in the partnership at the time of that organization?

A. Machinery, equipment, land, buildings, fixed assets.

Q. What went over to the corporation?

A. Everything else. [34]

Q. What is "everything else"?

A. Everything else, all assets, all liabilities, everything else.

Q. That included work in process, construction, cash in the bank?

A. Everything, everything, but there was a little note, as I recall it——

Q. There was a minor matter?

A. That became a fixed asset that was going to—we were going to repossess the thing, and we got it repossessed a few days after, so it was a fixed asset, but it was a note.

Q. Why did you determine to leave the fixed assets in the partnership?

A. Well, the operation by this man who I men-

(Testimony of Max Jeffrey Kuney, Sr.)

tioned who had become in the corporation is a different thing and a different responsibility than the mere ownership of fixed assets which children might be able to handle, but not the actual going out and building of buildings and roads, and et cetera. Furthermore, the man had \$86,000, and I wanted him to have a 20 per cent interest, and you can't have it with too big a corporation. So it was started at \$400,000, and when he came in it became \$500,000, and that is it. There is no room for anything else in there, you see. It would be a little [35] corporation so he could have a 20 per cent interest. If he had to have a 20 per cent interest in everything, he has no money like that.

Q. From that time forward what kind of business did the partnership engage in?

A. From that time they owned fixed assets.

Q. What did they do with the fixed assets?

A. They rented them to the corporation, that is, the user. The corporation can do it, subrent, and it does all the things it is to do. The partnership owns fixed assets, that is all, and it has continued right up to now.

Q. It is true——

A. (Interposing): It might change that now, however.

Q. It received rental income from the corporation for the use of fixed assets? A. Yes.

Q. Has that business continued from then to the present day? A. Right now, yes.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. At the present time the corporation is renting the fixed assets from the partnership?

A. Yes.

Q. Directing your attention to the last part of 1953 and 1954, how would rent be determined between the corporation and the partnership? [36]

A. Well, it was determined by Junior—by some formula he got out of an ADE book.

Q. What is an ADE book?

A. American—I don't know.

Q. American Equipment Dealer?

A. Yes, AED, American Equipment Dealers. I am familiar with this because I know what was done and changed. But finally the income that went there was computed by Mr. Carney for all those years.

Q. Who is Mr. Carney?

A. He is the income tax man. It is as shown in his report. He changed everything a little bit. It didn't amount to anything, I only bought one per cent, \$4,200, such a matter, and that was it, and we accepted that.

Q. In other words, the amount was ultimately approved and agreed upon between you and the Internal Revenue Service?

A. Yes, it was, as I say, less than one per cent change, but an entirely different method, I might say, but no change. We have accepted that and no question. Then we changed our method because there would be no more change, we hoped.

Q. With respect to the earnings of Max J.

(Testimony of Max Jeffrey Kuney, Sr.)

Kuney Company, the partnership, how were the profits earned by this partnership divided?

A. They can only be divided one way, that [37] is that.

Q. What way is that?

A. Well, first you must have reasonable salaries for the operating partners. I don't know what that might be.

Q. Who are the operating partners?

A. That would be Max, Jr., and me.

Q. Why do you call yourselves operating partners?

A. We are adults as distinguished from the children and the trustees who do nothing.

Q. While we are discussing the salaries, how much salary was paid to you by the partnership in 1952, do you recall?

A. 1952, it was quite a bit higher than it has been since, and I recall it was \$25,000.

Q. And that was because in 1952 the partnership was engaged in a complete general contracting?

A. Yes, that is true. And for a part of the time in 1953 it would be so. I would think that the salary for '53 would be somewhere between what it was for '52 and then '54, scarcely nothing.

Q. Isn't it true they paid \$10,000 salary in 1953 to you?

A. Well, if they did, I would say that that was about right. I don't recall.

The Court: Well, it is so stipulated, isn't it?

Mr. Biggins: That is correct. [38]

(Testimony of Max Jeffrey Kuney, Sr.)

The Court: All right.

A. I would think so.

Q. (By Mr. Toole): \$5,000 was paid in 1954?

A. Yes, that is five.

Q. And the reason for the decline was the change in the business?

A. Change in the things that we had left to do.

Q. From an operating business?

A. Just merely ownership of equipment. Five thousand dollars, I would say, is a nominal sum, and that could be one thousand as well.

Q. All right. Now, after these profits were—after these salaries were deducted from the profits of the partnership, how were the remaining profits divided?

A. That simply is a matter of arithmetic. You compute the proportion of the trust's income which it bears to the other partners' income, and it is a percentage run out through the machine, you run it out, and that is how it is. It can only be that way.

Q. Can you describe to the jury the principle or the—well, your agreement with respect to how this profit was divided, and in that connection I hand you Exhibits 24 and 25.

Exhibit 24, would you identify that to the jury?

A. Yes, this is an agreement dated the 11th of February, [39] 1952, which, incidentally, is the same date as the trust signed by me and also signed by Max, Jr., as trustee for the benefit of John, my son, by which, considering this now, I am a partner, he is a partner, and here is an agreement be-

(Testimony of Max Jeffrey Kuney, Sr.)

tween the two partners that they are to do this in relation to this income as is required to be done anyway. It just so states, which is well to state because there is no other place where that is stated.

It says, "The undersigned hereby agree that effective January 1, 1952, total Max J. Kuney income shall be distributed annually between Max J. Kuney and trust dated February 11, 1952, for benefit of John R. Kuney, as provided by the rules of law then effective for family partnerships and in conformity with the provisions of said trust."

In other words, this could last for thirty years, as I say. Laws could change, the agreement doesn't change. It is as provided, and it is as is stated, there is one last place there, the amount of salary which first must be deducted as a reasonable amount, and that is the thing that we can put down, what we think is reasonable, a reasonable amount. But someone else can come along and there can be a difference. It is a thing that has to be agreed. You can't state it. I have always had an idea I couldn't state a thing when it was some other [40] person's authority to change the thing. So I tried to make the agreement complete and completely fulfill not only now but forever this agreement which was made in 1952. It fits today.

Q. And in your opinion, referring to that reasonableness, were these salaries paid to you reasonable, in your opinion?

A. It was in our mind, as we set them down.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. Are you aware now that the government is saying they were too low?

A. Well, I don't know that—yes, you told me that.

Q. I told you the government raised that issue, have I not?

A. Yes, too low. I am not aware of which years.

Q. Did the partnership of Max J. Kuney Company file income tax returns from 1952 on?

A. Yes, I know that they did. Yes, they did.

The Court: It is stipulated. That is all stipulated to. Let us not unnecessarily go over stipulated facts. Let us speed this thing along.

Mr. Toole: Those partnership returns are Exhibits 9 to 13. I think we have them all in one group.

Mr. Biggins: There are two copies of the income tax returns for the years for the tax [41] reported that was paid.

The Court: Yes, that is all by stipulation.

Q. (By Mr. Toole): I will ask one question with respect of all the tax returns.

All of those income tax returns disclose the fact that the trust partners——

A. (Interposing): That is right.

Q. And they show each trust as receiving his share of the income as well as each adult partner?

A. They certainly do, yes.

Q. And the balance sheets on those income tax returns show the trust as one of the partners owning——

(Testimony of Max Jeffrey Kuney, Sr.)

A. (Interposing): That I wouldn't know unless I looked.

The Court: Well, if you know it to be a fact, say so, and let us get on with it.

Mr. Toole: It is a fact.

Q. (By Mr. Toole): Were financial statements prepared by the partnership, and I direct your attention to Exhibits 30 and 32.

Mr. Biggins: We are prepared to stipulate, your Honor, they are true copies of financial statements prepared, I believe, by Max J. Kuney, Sr., and so certified to by Mr. Bowen.

The Court: That is in the record. Go ahead.

Q. (By Mr. Toole): Those financial statements disclose the [42] existence of the trust, do they not?

A. They do.

Q. And the capital interest of the trust?

A. They do.

Q. And they show the share of the income of the trust?

A. No, they do not, not on the financial statement. They show the capital interest, but they wouldn't—obviously wouldn't show the share of the income.

Mr. Biggins: It is stipulated that the computation of the amount of difference——

Mr. Toole (Interposing): I simply want——

The Court (Interposing): Wait just a moment, we can't both talk at once.

Mr. Biggins: I would be happy to stipulate with Mr. Toole that by subtracting the difference in the

(Testimony of Max Jeffrey Kuney, Sr.)

amount reported on the capital accounts for the several years you could compute without——

The Court (Interposing): It is not set out as such?

Mr. Biggins: It can be computed.

The Court: I understand, but it is not set out as a separate item, but it could readily be computed from the financial statement?

Mr. Biggins: Yes.

The Court: Do you understand that, ladies [43] and gentlemen?

(Whereupon, there was an affirmative response from the jury.)

The Court: All right. Go ahead.

Q. (By Mr. Toole): To whom were copies of these financial statements furnished in this form of the computation that is disclosed?

A. Principally the one bank. We have always done business with that one and only bank and the only bank we ever borrowed money from, that is the Spokane Eastern of the Seattle-First National.

Q. Were financial statements furnished to them from 1952 on? A. Always and prior.

Q. Did you furnish a copy of the trust instruments to the Seattle-First National Bank?

A. I don't know.

Q. The evidence later will show that it was true.

A. It is also true they were furnished in full, complete form, to the surety companies, and we have

(Testimony of Max Jeffrey Kuney, Sr.)

only done business with one surety company. Those are the total and only two people who ever have been creditors of our firm.

Q. Didn't you owe money to any other creditors besides the bank? [44]

A. This firm has never owed a penny of money except current bills since it started. We are one of the only firms that has paid cash for equipment always. We have only had one creditor. We owed money, it was owed to the bank. There was never anybody else.

Q. Borrowings from the Seattle-First National Bank have been substantial?

A. Well, sometimes they were, yes.

Q. Now, referring to the trustee created by Max, Jr., of which you are the trustee——

A. (Interposing): Yes, sir.

Q. (Continuing): ——you filed income tax returns, which are here in evidence, Exhibits 17 through 22?

A. Yes.

Q. As trustee? A. I know I did.

The Court: It is stipulated.

Q. (By Mr. Toole): Income tax returns have been paid as shown by those returns?

A. They have.

The Court: That has all been stipulated to, Mr. Toole.

Mr. Toole: That is right.

Q. (By Mr. Toole): And a trust copy of the trust agreement was furnished to the Revenue Serv-

(Testimony of Max Jeffrey Kuney, Sr.)

ice when you first [45] filed those income tax returns?

A. Yes, that is required. I am sure it was done.

Q. Now, referring to the income earned by you as a trustee or rather the trustee's share of this partnership income, did you make any distributions of this trust—strike that.

As stipulated, you made payments in cash of income of this trust to Lorraine Kuney?

A. I directed that it be done.

Q. And to the bank? A. I did.

Q. Why did you determine to make distributions of income to them?

A. Well, that came to my attention in a visit with his mother.

Q. Were they in need? A. Yes.

Q. What was their health situation at the time?

A. Very ill.

Q. They were very ill? A. Yes.

Q. How old were they?

A. The grandparents were 77 and 82. But his mother was ill.

Q. Did Max Kuney suggest that you make these distributions?

A. He was certainly willing that the suggestion did come [46] from me, and it came. She wanted to sell her property. I knew she shouldn't, I told her she shouldn't.

Q. Your relations with Lorraine Kuney were cordial? A. Very friendly.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. At that time did you make any distribution—strike that.

You did make a distribution of the trust income to Jeff and to Caroline? A. Yes.

Q. How was that distribution made?

A. In the same manner as I have described, the salary taken off——

Q. No, you misunderstood the question.

From the income earned by the trust, you as trustee made distributions of 1952 income?

A. Correct. Yes, I do recall distribution to their personal accounts one year. That was done one year, yes. At my direction it was done in the year 1952 and not thereafter.

Q. What was the significance of that distribution?

A. That was to be a special thing that could be used especially for their education when the time comes.

Q. How was it distributed? Was cash distributed to them? A. No; credit.

Q. Credit, what do you mean by that? [47]

A. Well, another account would be set up, and it was distinguished from the account in trust. That account would be named and become the liability of the corporation, and it just states there their name, no trust in connection with it, Max J. Kuney, III, personal account, and in that would be a credit. It is a liability of the corporation.

Q. It is a liability of the corporation to him?

A. By the corporation to him.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. To the children? A. To that child, yes.

Q. One to Jeff and one to Caroline?

A. That is true.

Q. Has the corporation paid interest on those accounts? A. At all times, yes.

Q. Until the present time it still is?

A. That is right.

Q. During the period of your administration of this trust did you leave all of the property or capital of the trust invested in this partnership, or did you——

A. (Interposing): No, there came a——

Q. (Continuing): ——did you invest part in anything else?

A. There came a time in some year in the past when the trustee—the trust had more than enough money to own all the fixed assets. So then when that occurred, they [48] became a surplus over and above what they needed to have to own the fixed assets, and that is available for investment in fixed assets or otherwise, and when that occurs, that sets there in the corporation and it draws interest. But you see, there is a considerable trading done in these fixed assets.

For example, on the 10th of August of this year we sold a \$230,000 building, it is something like that. There is over a million dollars worth of—much more than that in the original cost. It fluctuates.

Q. Has any of the property been taken out of the Kuney family enterprises and invested elsewhere? A. Never.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. Why not?

A. We never do that. In the first place that is not the plan. In the second place, I know of no place that it will produce that income. In the third place, I do know, I believe, something about the construction business. Why should I put it in somebody else's business and in a piece of paper?

Q. Have you ever considered drawing any part of the trust investment out of the family?

A. I suppose. You see—sure, I considered and rejected it. You consider it and reject it. But it pays well and is safe. [49]

Q. How has that investment gone? Have you the figures at your disposal showing what the trusts are or were under your administration?

A. Yes, I know how they have grown.

Q. What have these trusts increased in value?

A. They have grown about as expected, maybe a little better. In other words, 15 per cent interest compounded after taxes. But the one, for example, for Jeff, he starts with \$50,000, and he now has \$109,000 after taxes and also \$27,000 in his personal account, a total of \$131,000 all springing from the same fifty thousand dollars. Caroline is the same.

Q. Did the formation of the corporation in any way reduce the share of profit earned by the trust?

A. Well, as it turned out, as a matter of fact, it happened to be beneficial to them, but we didn't exactly foresee it. It happens that the corporation had a bad year in 1959, but that certainly wasn't anticipated. As it turned out, why, the trust invest-

(Testimony of Max Jeffrey Kuney, Sr.)

ment back there in '53, when it was, now that has turned out to be very good.

Q. Are you as trustee free to withdraw this investment from the partnership and these family enterprises at any time you feel there is a better place for the money to be invested?

A. That is my understanding. I am free to withdraw my [50] decision, yes, sir.

Q. Why didn't you make any other distributions to Jeff or Caroline, or why didn't you pay any of the income out to Jeff or Caroline through these years?

A. It is sufficient as it was.

Q. Did they need any money?

A. They have never needed it, but they could. They are getting to the age that they could.

Q. But during the years involved here, they didn't need the funds?

A. Well, they got it from their mother and father.

Q. Their mother and father were adequately supporting them?

A. Yes.

Q. And particularly addressing yourself to 1954, were you instructed that any time by Max Jr., as to how you were to—as to whether or not you were to make any distributions of income from this trust? Were you instructed by Max, Jr., as to whether or not to make distributions of income?

A. Out of his trust?

Q. No, of the trust of which you are trustee.

A. Well, as it happened, it came—I, as trustee, instructed him in this particular case, because, well,

(Testimony of Max Jeffrey Kuney, Sr.)

I am not willing—because I presume I was the one that knew about this need in the family, and so forth. [51] And I did do that. I realized that when distributions—that I tell him what to do with that trust of his, direct him, and when it is a matter that is involved when you pay money to someone and how to handle it on the books, I would put that in writing because there is no misunderstanding, so I do that.

Q. Do you mean that Max, Jr., was in Spokane with a bank account?

A. Yes. I just merely wrote Max, Jr., a letter—a memo that he would understand, of course, that he was to instruct his bookkeeper to actually carry on this thing of writing a check and doing the thing.

Q. But at any time did Max, Jr., instruct you or tell you how to make any dispositions of the income of the trust that he created and of which you were the trustee?

A. No, there is never any occasion. He never, that I can recall, had anything to say about that because—with the exception of this Bently and his mother's distribution, and the other distributions are really just automatic. There is only one decision to make, "What is the reasonable salary," then it is a computation by arithmetic, and there has been no reason for even a discussion about what to do about that.

Q. Would you consider yourself bound by instructions by Max, Jr., as to how you were to act as a trustee? [52]

(Testimony of Max Jeffrey Kuney, Sr.)

A. Well, no, I understand it is the reverse.

Q. Do you consider that you are the only——

A. (Interposing): I am a trustee.

Q. And you use your own judgment?

A. I am the one that is in charge of that trust. That I am very aware of. Sometimes it gets confused. I can only think it is for the children I am their trustee. Now, it is for the benefit of the children, I am their trustee, and I have charge of it. I have the control of it as trustee. That is my duty to do, and that is the way I understand it, and the same as to him.

Q. You don't consider yourself bound by any suggestions he might make? That is, bound by suggestions he might make regarding the distribution?

A. I would certainly listen to him. I am not bound. As a matter of fact, by the same token he is not bound, as I understand.

Q. I want to explore that with respect to the trust you created of which he is the trustee.

A. He is the trustee.

Q. Which he is the trustee of? A. Yes.

Q. For the benefit of your son Johnnie?

A. Yes.

Q. Do you control his actions now as to how he is to handle [53] that?

A. No, not at all. If there is nothing—the things that he will do of importance there will be done, I presume, after my death. He controls that in the same way, but it is a little simpler in this respect, there were no other beneficiaries. There absolutely

(Testimony of Max Jeffrey Kuney, Sr.)

hasn't been anything to do about that. It has been in existence all these years except a decision once that we will invest it in fixed assets. There is now about to come up another decision, but that has no part here. But we are going to discuss the changing of those investments.

Q. In other words, for some time you have been wearing two hats in the administration of the partnership, is that one way to think of it, a trustee?

A. If you want to say so, I am a corporation, I am a partnership, I am used to that thing.

Q. You are accustomed to acting in more than one capacity in business relations?

A. I probably have a great many partnerships, yes.

Q. Do you find it difficult in your own mind to divorce your responsibilities as a trustee to Caroline and Jeff when you are making these business decisions?

A. No. First, I recognize they are my grandchildren. There is that feeling that is present. That is a human thing, I know that, and I want to take care of those [54] grandchildren whether I am trustee or whatever you call it, call it a grandfather. Then I am a trustee, another hat, that is business only. That is your control of some investments how they do them and later things.

(Whereupon, there was a brief pause.)

The Court: Let us speed this along, if we can, please.

(Testimony of Max Jeffrey Kuney, Sr.)

Mr. Toole: I think that will be all, your Honor.

The Court: We will take the recess before the cross-examination.

(Whereupon, a short recess was taken.)

The Court: Cross-examine, please.

Cross-Examination

By Mr. Biggins:

Q. May it please the Court, Mr. Kuney, sir, I understood you to say, Mr. Kuney, that some time around the winter of 1951 you read an article of the American Institute of Research about family partnerships? A. Research Institute of America.

Q. Excuse me.

A. It was the Research Institute of America, I believe it is.

Q. That is the correction I desire to give, Mr. Kuney, [55] "RIA." Research Institute of America. A. I believe so, yes.

Q. And that publication, Mr. Kuney, is a tax publication, is it not? It is not a business publication, it is a tax-saving publication, isn't that correct? A. That is correct.

Q. And on your occasion of your reading that tax publication, I believe, sir, at that time you were in the ninety per cent tax bracket? There is no denying that either, is there?

A. I believe that is a fact that that year I came in that bracket.

Q. And having read, and I believe you said,

(Testimony of Max Jeffrey Kuney, Sr.)

somewhat understood that tax article, you then went to who? I didn't get the name?

A. First I went to the office of Mr. Tracy Griffin.

Q. And is he an attorney or an accountant?

A. No, he was a lawyer. He has since died.

Q. In Spokane or Seattle?

A. In Seattle, sir.

Q. And in that office, I believe, sir, you read over a great number of trust instruments which he let you examine?

A. Two only.

Q. Two only? [56]

A. Yes.

Q. Which you examined, I take it, sir, with some care?

A. Yes, I was able to read them quite rapidly.

Q. It was after that that you went over to Spokane to Mr. Witherspoon's office and discussed the trust problem with him?

A. Yes, it was after that. That was the first thing I did.

Q. And you had more than one conference with Mr. Witherspoon about the trust?

A. I believe it was only one conference, and at that time he made the draft of a trust which stated that it was a rough draft, and it was read, approved, a final draft was made and signed. I believe that is the sequence.

Q. And signed, I believe, on February 11, 1952, in Mr. Witherspoon's office?

A. My copy was signed in Seattle, sent to me in Seattle to sign. I signed it in Seattle. I am quite

(Testimony of Max Jeffrey Kuney, Sr.)

sure I signed it in Seattle and returned it by mail. I may be mistaken.

Q. But it was signed on February 11?

A. Yes, that is the date.

Q. Now, in reading that article in the RIA, the tax magazine, you do recall that that article said in creating a family partnership you must be very careful of the partnership agreement entered into? Do you recall that? [57]

A. No, I don't recall that in this particular article.

Q. They did discuss the partnership agreement?

A. Not in that article.

Q. You don't recall it?

A. Well, it was not in that article. I have the article.

Q. You have it?

A. In my office, yes. This book, incidentally, contained other things. I have kept the book. I often refer to it.

Q. Regarding other things about taxes?

A. Yes, and also tax tables that were necessary things to use.

Q. Now, I believe you did mention a partnership with these other gentlemen like Mr. Johnson, didn't you?

A. Yes, I did.

Q. And we did have written partnership agreements with Mr. Johnson?

A. Yes, there is a written agreement concerning Mr. Johnson.

Q. And with Mr. Greene?

A. Yes.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. And you will recall, of course, that you also had a written partnership agreement with your own son, Max, Jr.?

A. Yes.

Q. All right. And included in that partnership agreement you had with your son, that is the period '39 through [58] '52, that date is correct, isn't it, Mr. Kuney?

A. I believe so.

Q. And included in that agreement you had with your son was the understanding, "The father shall continue as the nominal head of the firm with final decision on all matters pertaining to the firm, but it is contemplated that the father will gradually retire from active management with decreasing duties and responsibilities and that the son will take over increasing duties and responsibilities, but always with the father continuing in full authority with final decision on all matters pertaining to the firm."

You do remember something like that?

A. I remember that.

Mr. Toole: What is that instrument, your Honor?

(Whereupon, a document was handed to Mr. Toole by Mr. Biggins.)

Mr. Toole: I am totally unfamiliar with this instrument.

The Court: That is unfortunate. Let counsel follow it if he wishes. But the cross-examination must not be interrupted, of course.

Go ahead.

Q. (By Mr. Biggins): We have established, I

(Testimony of Max Jeffrey Kuney, Sr.)

believe, [59] Mr. Kuney, we did have a written agreement with your son?

A. I know that agreement, I wrote it.

Q. And also in that agreement you understood, "The son shall give all his working time to the firm's business, diligently pursue knowledge of the same in his spare time, and at all times actively superintend and manage its affairs. It is contemplated that by the very nature of the firm's business the responsibilities of the son will be heavy and that his duties will involve a great amount of traveling with the hardships of a transient family life. This is fully understood between the parties hereto and the transfer of these duties and incident hardships from father to son is the very essence of this agreement."

You do remember that?

A. I am sure that it was in the——

The Court: The point is, you do recall that was provided in the agreement with your son?

The Witness: Definitely.

Q. (By Mr. Biggins): Also do you remember the understanding, "It being considered that under the duty contemplated for each partner the father will furnish experience beyond that of the son while the son will perform work beyond that of the father, therefore, their respective [60] salaries and shares in the firm's profits shall be equal, provided, however, that before any profits are divided the father shall receive interest at the rate of three per cent per annum on the amount if his capital account exceeds the son's capital account, except that this pro-

(Testimony of Max Jeffrey Kuney, Sr.)

vision shall not operate until hereafter there shall have been the sum of \$50,000 profits first divided equally between father and son."

Do you remember that, too?

A. Yes, I remember that.

Q. As well as the other provisions discussed and understood and executed by you?

A. I remember that, and the purpose of it and its meaning very well. That was a very important partnership agreement in my life, the most important.

The Court: Well, all Mr. Biggins is getting at now, Mr. Kuney, is the fact that you did have a detailed partnership agreement between you and your son in which all of these matters that he has referred to, as well as others, were spelled out in detail?

The Witness: That is true.

The Court: All right. Go ahead.

Q. (By Mr. Biggins): If you will, Mr. Kuney, I have asked Mr. Grant, the Bailiff, to make available to you a [61] number of exhibits, Exhibits 1 and 2, which I believe you will recognize as the two trust agreements. A. Yes.

Q. Exhibits 24 and 25, the agreements which you spoke about on direct examination a few moments ago? A. Yes.

Q. And in addition to that the rental agreement, the Dun and Bradstreet reports, and I believe, if you will look at the bottom of those made available,

(Testimony of Max Jeffrey Kuney, Sr.)

the corporate units, the stock book, Defendant's Exhibit Q—do you also have that there, Mr. Kuney?

A. Yes.

Q. Now, going through these, if I may, sir, in chronological order as much as I can, could we take that first trust instrument. That is the trust of which you were the trustee, Exhibit 1, is it not, Plaintiffs' Exhibit 1?

A. Yes.

Q. And looking at that, as I read some parts very rapidly—

The Court: Not too rapidly, we must all hear you. Tell him the page and line.

Q. (By Mr. Biggins): That was the trust agreement, I take it, Mr. Kuney, that you executed February 11 in Seattle, Washington, received by mail and sent right back?

A. I said that I was not certain of that. I believe so.

Q. Whatever your recollection is, we understand it is a [62] long time ago.

A. That is true.

Q. But you do remember signing it?

A. I did sign it.

Q. And this is the trust that you considered in draft and discussed in conference with Mr. Witherpoon and then had a revised draft executed? That is that instrument?

A. That is the instrument.

Q. Now the first page, if I may somewhat read rapidly as you follow me, I am reading, Mr. Kuney,

“Whereas, Max J. Kuney, Jr., is in the general contracting business, carrying on such business in

(Testimony of Max Jeffrey Kuney, Sr.)

partnership with others under the firm names of Max J. Kuney Company, Kuney-Johnson Company, Agutter Electric Company, and Techler Aluminum Products; and

Whereas, it is the intention of the grantors to make a gift in trust for the benefit of their minor children and others of a percentage of their interest in each of said partnership businesses; and

Whereas, it is the intention of the grantors that the sum of such percentages so to be given by them in trust for the benefit of their minor children and others shall equal \$100,000.00 in value.” [63]

You have seen that language there?

A. Yes.

Q. And then we set up that \$100,000 under the capital account, as you described it, and may I turn now, if I may, sir, to Section 1, Article II, on Page 2?

A. Yes.

Q. We are talking there, I believe, about the powers of the trustee?

A. Yes.

Q. Section 1:

“The trustee shall divide the trust estate into two equal funds, one for the benefit of Max Jeffrey Kuney, III, a son of grantor, and one for the benefit of Caroline Ireland Kuney, daughter of the grantor. Each of said funds shall be deemed to be and shall be administered as a separate trust.

The trustee shall hold, manage, invest, and reinvest the funds of the trust estate, shall receive the income therefrom, and shall, after paying the reasonable and proper expenses of the trust, pay and

(Testimony of Max Jeffrey Kuney, Sr.)

distribute the principal thereof, and the income therefrom, as follows:

Section 1. The trustee shall have the right in his sole and uncontrolled discretion to pay to [64] Lorraine B. Kuney, mother of the grantor, Max J. Kuney, Jr., to Clayton H. Bently, grandfather of the grantor, Max J. Kuney, Jr., and to Mabel C. Bently, grandmother of the grantor, Max J. Kuney, Jr., or to any of them, such portion or portions of the income of the trust estate as the trustee may deem necessary to provide for the support, health, maintenance, welfare, and enjoyment of such person or persons, due regard being given by the trustee to the other sources of income of such persons."

You do see that in that instrument?

A. That is there, yes.

Q. And it is clear in your mind that it is your discretion and nobody else's——

A. (Interposing): It is my discretion, yes.

Q. Your sole and uncontrolled discretion, you understood that? A. I understand that.

Q. And in that same article on the next page it was further provided, you see at the last sentence of Section 2:

"The trustee's determination as to whether or not payments shall be made to the persons named in this section and the amount of such payments shall not be subject to judicial review." [65]

You understood that as you executed this instrument, "shall not be subject to judicial review"? That is in the instrument, isn't it?

(Testimony of Max Jeffrey Kuney, Sr.)

A. It is there, yes.

Q. And in Section 3 there:

“The trustees shall have the right at any time, and from time to time, after a child of grantors for whom a share or fund of the trust estate is set aside attains the age of twenty-one years, to pay over, transfer, assign, convey, and deliver unto said child all or any portion of the share or fund then being held for the benefit of such child, as the trustee, in his sole and absolute discretion, deems to be for the best interest of said child.”

You do see that? A. Yes.

Q. You do also recall that? A. Yes.

Q. Again, “his sole and absolute discretion.”

A. Yes. In every place it was stated here, I recall that, and expected to find it there when I read the trust.

Q. Why did you say you expected to find it there?

A. Because I had read these other trusts and considered that that was the way trusts were made, and to the best [66] of my knowledge that was the correct and proper and legal way, and I didn't even question it. I don't know whether I was correct or not. Those are the things I have seen. I knew of no other type of trust. Those are the first trusts I had ever seen in my life when I went to Mr. Griffin's office.

Q. In that contact, then, if you will, Mr. Kuney, please turn to Page 10 with me to Section 8, where I read:

(Testimony of Max Jeffrey Kuney, Sr.)

“The trustee hereunder——”

and that is you, we are clear on that? A. Yes.

Q. “The trustee hereunder, his successors and substitutes——”

And the “successors” was your son, we are clear on that? A. Yes.

Q. “——shall be and he hereby is relieved from any and all of the duties imposed upon them by Chapter 229 of the Laws of 1941 of the State of Washington, as amended. Such trustee, his successors or substitutes, shall further be relieved from any and all duties so far as the grantors are able by this instrument to relieve him, which may in the future be imposed by amendment to said Chapter 229 of the Laws of 1941 of the State of Washington, or by any future [67] law or laws of the State of Washington, or by any existing or future law or any other state with respect to making or filing with any court or other place any report, inventory, or accounting of the principal or income of the trust hereby created.”

Now, my question, Mr. Kuney, in the trust instrument that you read in this man’s office, did this provision relieving the trustee from all this state law, did that exist in any of the trust instruments which you examined?

A. I am quite sure that it did. I found nothing, as I stated, and I read them there and got familiar with them, and then I found nothing in this one that Mr. Witherspoon prepared that was strange to me.

Q. But you do then recall, sir, that you insisted

(Testimony of Max Jeffrey Kuney, Sr.)

that such a provision do appear here before you executed it?

A. No, I didn't insist on that at all. I stated it happened as I told you. Mr. Witherspoon was known to me by reputation as a trust lawyer. That is his business. I know of his past, I know of his father, I know what the business is and was, and I wouldn't even—I wouldn't question his judgment on a matter of this kind because it is a thing I know nothing about. I didn't insist, I wouldn't know of anything like this.

The previous thing "under judicial review" is a [68] thing that apparently I hadn't even read before or read it but meant nothing to me. That means something to me, apparently the trustee can't be held liable, but I know different, by the way, regardless of what this may say. I think I know different because I have inquired.

Q. I had it understood, Mr. Kuney, from your direct testimony to say in effect as to the powers of trustee, it was something you were insistent on and understood and that under this instrument you had all the power with respect of this property that, I believe, your words were, a natural man would have. Do you recall that testimony?

A. I didn't—as I recall, I didn't testify that way.

Q. Did you express that thought accurately now?

A. No, this is what I believe I said or intended to say, that I had first read these trust instruments,

(Testimony of Max Jeffrey Kuney, Sr.)

because it was a new thing to me, and I wanted a little experience in the various types of trust——

The Court: You are getting afield, Mr. Kuney. What did you understand with respect of the powers of the trustee here? How wide were they?

The Witness. Absolute. I said that before, it didn't shock me when I saw it before.

Q. (By Mr. Biggins): As far as you know, Mr. Witherspoon did draft this document accurately in accordance with [69] your instructions and expressed intent?

A. I made no instructions, and I am sure no one made any instructions to Mr. Witherspoon as to the drafting of these matters here except right on about the first page, the hundred thousand dollars, and he would consult with us something about age thirty. But after this, I really don't think it would be—in my way of doing business some of these things wouldn't be the natural thing for me to do.

Q. I understand you to say, Mr. Kuney, you gave no instructions on this instrument?

A. Not in relation to such language as this. I may be wrong, but I did think that it was a sort of a form that was a legal form, and Mr. Witherspoon said it was so, and my concern was this only, that it had to be a trust. I certainly wanted it legal and correct.

Q. We are absolutely clear on that?

A. I am clear that that is what I wanted.

Q. And considered it a complete and accurate trust instrument, we are clear on that?

(Testimony of Max Jeffrey Kuney, Sr.)

A. That above all things. Certainly I wouldn't want to fail because of some instrument of this kind.

Q. I did notice in Sections 4 and 5 of this instrument, Mr. Kuney, that if, say, one Jeff—that is what you call Max III? [70] A. Yes.

Q. If Max should marry and fail to have children—if Max should marry and have children and passed away, of course, his share goes to his children, you did understand that? A. Yes.

Q. And you testified? A. Yes.

Q. But if the marriage fails to have children and then passes away, his wife gets nothing, it goes to the other grandchild? You understood that also, but if Max marries and has children——

The Court: Do you mean Max III? There are three Maxes here.

Q. (By Mr. Biggins): If he marries and fails to have children, his wife gets nothing at all if he passes away? A. Yes.

Q. If John marries and fails to have children and passes away——

A. (Interposing): Yes.

Q. (Continuing): ——his wife gets nothing?

A. Yes, I do understand that. I like that, and I understand it thoroughly. I like that agreement. I like that part. [71]

Q. Now, on that very same day, Mr. Kuney, on that very same day this very important trust instrument was considered, drafted, executed on February 11, 1952, there was another agreement executed, I believe you said? A. Yes.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. What was that other agreement that very same day, February 11, 1952? Looking at Exhibits 24 and 25, would that help us?

A. That was merely a short agreement.

Q. A short agreement of what, sir?

A. Agreement of what to do under this trust agreement and partnership that I had not found completely covered in this agreement. I consider that when you take this agreement of this date, this agreement also of the same date, plus the things referred to in this date, there has been automatically covered everything that needs to be covered in any partnership agreement. There is nothing more to be said. It has everything in it, and this does refer to this, and it refers to the regulations which are a necessary part. You cannot distribute this thing and make it valid except by whatever regulations—the tax regulations say and makes it taxable. So the three, to my mind, were necessary to make a complete agreement.

Mr. Biggins: May it please the Court—— [72]

A. (Continuing): ——a complete statement of the agreement. There is other things, of course, in the partnership agreement, or else, and so forth, and always have been with me.

Mr. Biggins: May it please the Court, as I review my examination here I would request and appreciate if Mr. Grant passed Exhibits 1 and 24 and 2 and 25 to the jury for examination.

The Court: That may be done.

(Testimony of Max Jeffrey Kuney, Sr.)

(Whereupon, certain documents were passed to the jury.)

Q. (By Mr. Biggins): So the record may be clear as we pass those two together, Mr. Kuney, your testimony saying that this relates to that, so we will be clear in the record here, you are meaning that the trust, Exhibit 1, related to the agreement, Exhibit 24, about the distribution of profits, that is true, isn't it?

The Court: Would you just listen a moment before you read? I want you to hear, and it is difficult to read and listen. I try it all the time up here, and I have to do it because I have other work of the Court going on all day long here. But it is difficult and especially so if you are not trained to do that.

I would like that last question and answer [73] read to the jury.

Mr. Biggins: May I restate it?

The Court: Yes, please do that.

Q. (By Mr. Biggins): Exhibit 1, which Mr. Grant passed to the jury, you will recall, Mr. Kuney, is the trust? A. Yes.

Q. For Jeff and Caroline, of which you are the trustee, is it not? A. Yes.

Q. And Exhibit 24, which I requested be coupled with that, Exhibit 24 is the agreement about the distribution of partnership profits which you considered and executed in conjunction with Exhibit 1?

A. Yes.

(Testimony of Max Jeffrey Kuney, Sr.)

Mr. Biggins: Could we pass those along?

The Court: Yes.

(Whereupon, documents were passed to the jury.)

The Court: Now, let me just suggest this to you, you will have ample time later on to read these documents in detail. Don't attempt to do that now. Just glance at them so as to get an idea of what they are about. Do not read them word for word. Just take a glance at them so that your mind will recall them later when it comes time to study them carefully. [74]

That is what you have in mind?

Mr. Biggins: Yes, your Honor.

The Court: Pass them along.

Q. (By Mr. Biggins): Of course, the second part of my question, Mr. Kuney, was Exhibit 2, the trust for your other son, John Richardson Kuney, of which your son Junior is trustee, is also coupled with Exhibit 25, a similar type of agreement, isn't that true? A. Yes.

Mr. Biggins: And we have passed those to the jury?

The Bailiff: They are passed to the jury.

Q. (By Mr. Biggins): As we think about those instruments, Mr. Kuney, may I ask you this, in going over to this office where you looked at the trust instruments, are you mindful of that attorney's office now? A. Yes.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. Did you also request that he show you partnership agreements for your examination?

A. No, I made no—nothing else. The trust was the thing that I didn't know about. I thought I knew about partnerships. I knew nothing. I never asked anybody.

Q. Well, all right. Now, we have this conference——

The Court: Excuse me, let us just let the jury pass those along now, and we will pause for a [75] moment so they may do that. Just glance at them and get an idea so that you will recognize them later on.

(Whereupon, there was a brief pause.)

Q. (By Mr. Biggins): Now, I notice, and please look at these instruments if you think necessary before answering my question——

A. Yes.

Q. Now, I notice, Mr. Kuney, in examining the trust agreement that we are concerned at least about a provision in that instrument about the “law of the State of Washington.” That is so set forth in that instrument?

A. The law of the State of Washington?

Q. May I direct your attention.

A. Yes, I see it now.

Q. In looking at Exhibits 24 and 25, I notice in that agreement, Mr. Kuney, no reference to the laws of the State of Washington, but rather to the rules, and you may follow the language with me,

(Testimony of Max Jeffrey Kuney, Sr.)

please—"the rules of law then effective for family partnerships—" Do you see the words "family partnerships"? A. Yes.

Q. Why the difference between those two instruments? The one was "State law" and the other "income tax law" about family partnerships. [76]

A. Well, may I first point you to the matter of time of the date that this was done?

Q. Certainly.

A. If at that time there are any code regulations that had been published yet, I don't know that they had, I have never seen them, but I was——

Q. (Interposing): Excuse me, may I make clear, when you say "code regulations" you mean, of course, Internal Revenue code?

A. I do, yes, sir. If there had been, I hadn't seen them. But I am explaining only this as you asked me to do. In this American Research Institute form that I did have and that I do have, I was alerted to a certain thing. But these other things, other things which I have forgotten, that you said were in there, I did not find there. I find some other things about what you do about if your son is in the service and so forth, which is glossed over and does not fit me—that the Treasury Department would contest these cases, and that it was important to observe these rules. All right. I did not know what those rules might be, but whenever they were published, I wanted them to be observed, and I so stated, and if they should be changed, I wanted them to be observed as changed, and I have so stated.

(Testimony of Max Jeffrey Kuney, Sr.)

I attempted in my way to make this thing last for [77] the term that I felt that it was important, and that was until the children were thirty years old, and as I see it, even though I didn't know what the rule was then, an agreement was then made that is valid and is able—that I know that at least the partners that are party to this thing thoroughly understand what is meant here by what these rules are and what they must do. That point is plain.

Now, if I was mistaken in thinking that this trust agreement itself whereby the trust becomes a partner is not itself a partnership agreement, then I am afraid I am mistaken. But it certainly does contain the thing and more things than I have ever even thought of putting in any of them—any partnership agreement I have made, and they have been many. But nevertheless, I do recognize that this is for a different purpose, and, therefore, can contain those things. But I do believe that it was my belief then, and it is now, that this plus this (indicating) plus those rules, if and when they are published, do make an absolute and complete set of rules as to how this partnership is to be governed and conducted, and at least we have found to date that they do have as between us without any trouble whatever.

Q. Mr. Kuney, in my questions I shall attempt to make it easier and quicker to answer. [78]

A. Well, if my answer is too long, I regret that.

Q. You did regard this agreement as a serious and deliberate business document, didn't you?

(Testimony of Max Jeffrey Kuney, Sr.)

A. It was—the trust agreement itself was a necessity because the children were minor.

Q. I am speaking of Exhibit 24. You did regard Exhibits 24 and 25 as serious?

A. I regarded this as the necessary part of this (indicating), yes, and knowing that——

Q. Would you listen to my question, please?

A. Serious?

Q. A serious and deliberate business document, that was important to you?

A. Serious, no, as I know the meaning of “serious,” sir.

Q. May I use the word “important”?

A. Yes.

Q. An important business document to you?

A. Yes.

Q. And it being an important business document, you, of course, discussed it with your attorney, didn't you?

A. No, I did not.

Q. Did your son discuss it with his attorney before he executed it?

A. Not that I know of. I am the one that was responsible for this thing. I am the one that typed the two things [79] the same way and signed them one place, and we should sign this when we have this thing completed.

Q. Excuse me, you said “We should——”

A. I prepared the document, and it shows where each one——

Q. You are referring to Exhibit what?

(Testimony of Max Jeffrey Kuney, Sr.)

A. Exhibit 24, and the other one is 25, both identical wording except the change of name.

I did prepare them, and at that time I considered this was the thing that I was in total ignorance of. This is an attorney's job.

The Court: Now, Mr. Kuney, I am sorry, but when you say "this" and "that," you must say what the exhibit number is so that we have some way of identifying it in the record.

A. I mean this trust agreement, Exhibit 1, was the thing that I never had any experience with and knew nothing of, prepared entirely by attorneys. But certainly when I read the terms, I thought I understood them, and I thought that is all right, and certain terms, I thought that was very good, and the others I thought that was a part of the usual formal trust agreement and went over it.

Q. (By Mr. Biggins): If you will, please, Mr. Kuney, to inquire into a little different area now, would you take Exhibit Q and have that before you, sir? [80] A. Yes, sir.

Q. Now, this question is quite important to us, the government, Mr. Kuney, so please think about it before you answer.

In 1953 we did form the Max J. Kuney Company, didn't we, the corporation? A. Yes.

Q. Now, at that time what was the understanding and agreement of the parties—and by "the parties" I mean you and your son as trustees—are we together so far?

The Court: Are you following up to that point?

(Testimony of Max Jeffrey Kuney, Sr.)

The Witness: I believe so.

The Court: All right.

Q. (By Mr. Biggins, continuing): You in your capacity as trustee and your son in his capacity as trustee, what was your agreement and understanding as to who it was that would own the corporate stock in this corporation? A. 1952?

Q. Excuse me?

A. 1953 and '4, it was our understanding at the beginning——

Q. (Interposing): By “the beginning” do you mean 1953?

A. At the very beginning when it was formed, the corporate stock would be owned by the various parties in their [81] various capacities. In other words, naming them by “Junior,” by “Senior,” by three trusts, altogether known as the Kuney family partnership. That was the original thing that was done. We changed that——

The Court: Now, don't get into anything. Answer this question first. What was your intention and understanding in 1952 when the corporation was formed as to who would own the stock of that corporation?

The Witness: Well, I answered that. I can leave the last part out.

The Court: Just tell us right to the point of who it was that was to own the stock in the corporation at that time.

The Witness: The Kuney family partnership.

Q. (By Mr. Biggins): Now, and you say at a

(Testimony of Max Jeffrey Kuney, Sr.)

later time it was changed? A. Yes.

Q. All right. Now, let us look at your corporate minutes, Mr. Kuney, which will be at the bottom of Exhibit Q, for February 7, 1957. Will you look at that on Page 2, at the bottom of the page where it says, "The chairman next pointed out"—

The Court: Wait until he finds it first. Have you got it now? [82]

The Witness: No.

The Court: Show him where it is.

Mr. Biggins: May I approach the witness, your Honor?

The Court: Yes. Point it out.

Mr. Biggins: It is right here (indicating).

The Court: Why don't you read it and let him follow. Just be sure you are reading right. Read the part that you want or point out to him what you want him to read. Have you got a copy?

Mr. Biggins: Yes, your Honor.

Q. (By Mr. Biggins): "The chairman next pointed out—" and would you read that, please, Mr. Kuney?

The Court: These are minutes of what date?

Q. (By Mr. Biggins): If you will turn to February 7—excuse me, February, 1957, your Honor.

A. 1957?

Q. Yes, February, 1957. A. Yes.

Q. And the chairman at that meeting, of course, was you, are we clear on that? You were the chairman? A. Yes.

Q. All right. A. And I was president.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. "The chairman," meaning you, "next pointed out—" [83] could you read it for us, please?

A. Yes.

"The chairman next pointed out that the original corporate stock issued in a single certificate in the amount of \$400,000 to the Max J. Kuney Company partnership was incorrectly issued and the stock should have been issued in two separate certificates in amount of 200 thousand shares each, one to Max J. Kuney and one to Max J. Kuney, Jr."

Q. That is far enough unless you wish to continue, Mr. Kuney. The stock was incorrectly issued?

A. That is the wording, yes.

Q. And that was the wording you used at that meeting as chairman?

A. These are the words in the minutes.

Q. And so as a result of that incorrect issuance of the stock, after discussion and motion the following resolution was adopted:

"Resolved, that the directors of Max J. Kuney Company are hereby authorized to recall and cancel the original stock certificate issued to the Max J. Kuney Company partnership and replace this certificate with two separate certificates in the amount of 200 thousand shares each, one to [84] Max J. Kuney and one to Max J. Kuney, Jr."

That is what it states there?

A. That was done.

The Court: Well, that may be, but just follow the question, Mr. Kuney.

Go ahead. It so states.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. (By Mr. Biggins): As a result of that action, Mr. Kuney, we took—we completely destroyed——

The Court: You had better avoid the use of the word “we.” The jury will think you did it.

Q. (By Mr. Biggins): As the result of this corporate action of canceling the certificate made out to the partnership, after that was done, Mr. Kuney, you, of course, understood that Jeff, Caroline, John Richardson, no longer had any interest at all in that corporation? You understood that?

A. I understand that.

Q. All right. Although that wasn’t the original intent at all at the time that the trust instrument was executed? A. No.

Q. And although the minutes—as the official minutes of the meeting, at which you presided, states that was all a mistake? A. Yes.

Q. And although in the deposition—you do recall we [85] took a deposition some weeks ago?

A. Yes.

Q. You do recall that? A. Yes.

Q. Although that is not the same story you told us at that time? That is true, isn’t it?

A. I don’t know that, sir.

The Court: All right. Read the deposition.

A. I don’t believe that——

The Court: You don’t recall having made any statement at the time the deposition was taken contrary to what you state now?

The Witness: No, I don’t recall that.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. (By Mr. Biggins): Do you recall on Page 27 of the deposition taken in Spokane on May 4, 1960, in answer to a question where you stated——

The Court: Excuse me, just a minute, this is the official transcript, Mr. Kuney. You may follow that as read. Go ahead.

Q. (By Mr. Biggins): Let us turn over to the other page to be absolutely clear that I have left nothing out, Mr. Kuney, and let us see Mr. Anderson's question, Line 23,

“Well, now, let me see if I——”

The Court: Let him find it first, please. [86]

Line 23, what page?

Mr. Biggins: Page 26.

Q. (By Mr. Biggins): Do you have it with me, Mr. Kuney? A. Yes, I have it now.

Q. “Question. Well, now, let me see if I have got this straight, and you say that in the beginning in 1953——”

A. No, I don't have it. That is not what it says on this page. What page again, sir?

Q. Page 26, Line 23.

A. Yes, now I have it.

The Court: Now he has got the place. Read it to him.

Now, Mr. Kuney, let me explain to you, counsel is going to read the question and answer, maybe several to you now, from the transcript, and he will then ask you if this is not a correct reading of the transcript and your testimony at that time, which is what you are to respond to.

(Testimony of Max Jeffrey Kuney, Sr.)

Is that clear to you?

The Witness: Yes.

The Court: Go ahead.

Q. (By Mr. Biggins): And the question beginning on Line 23, Page 26,

“Well, now, let me see if I got this straight, [87] you say that in the beginning in 1953, or was that January the first?”

You answered,

“Of course, yes.”

The next question,

“Now, of course, in '53 you created a corporation?” Yes.”

“And this corporation did what?”

“It is the operating organization of the construction business. It operates the construction contracts.”

“And who were the stockholders in this corporation?”

And what was your answer to that, “And who were the stockholders in this corporation?”

A. “My son and I, and there have been stockholders added since that time.”

Q. My question, “But these trusts have never had any interest in that then?” What was your answer? Your answer, sir, was what?

A. “The trusts have never had any interest in the profits and losses of the corporation.”

Q. “The trusts have never had any interest in the profits and/or losses of the corporation?” [88]

A. Yes.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. Would you care to explain that answer?

A. I believe I am mistaken.

Q. I see. All right.

A. That is my answer.

Q. But this much we are very clear on, I believe, then, at this time, Mr. Kuney, that in the beginning the children, Jeff, Caroline, and John did have an interest in the corporation? A. Yes.

Q. Signals were changed at a later time by you or by you and your son? A. By——

Q. Very well. That is your wording.

The Court: Well, that is the wording that is in the minutes. You say, "The chairman pointed out——"

A. I misunderstood him. I thought you said "Signals were changed."

Q. (By Mr. Biggins): They were later deprived of that interest, weren't they?

A. The investment was placed elsewhere, and they were deprived of their interest in the corporate stock, and their money was invested elsewhere.

Q. They were deprived of their interest in the corporation, [89] weren't they?

The Court: Please answer directly to the question.

A. Yes.

Q. (By Mr. Biggins): And all they had left was the interest in the fixed assets which were leased to the corporation, leased or rented, that is all? A. That is what they had.

Q. And you have never in your long business

(Testimony of Max Jeffrey Kuney, Sr.)

life ever treated a business partner that way now, have you? A. (No response.)

Q. Let us speak about the rent then, Mr. Kuney. You did say, I believe, sir, that the only——

The Court: The record will show no response to the last question.

Go ahead.

Q. (By Mr. Biggins): You did say, I believe, Mr. Kuney, that the only computation that had to be made was the salary computation to see what income would flow into these trusts. Did I understand that correctly?

A. That would not be a computation. I meant to say that before you could make any computation, you have to arrive at the reasonable rate to be deducted. Therefore, the computation to be made would certainly be to compute the percentage interest of one to the other. [90]

Q. Well, in the beginning, I believe, sir, that the profit that you received from the partnership was shared with the beneficiary of your trust, John Richardson, that is clear, isn't it?

A. Yes, it was.

Q. And the way in which that profit from the partnership was shared was in proportion to your capital account? A. Yes.

Q. If his account was ten per cent, you would get 90 per cent, he would get ten?

A. That is correct.

Q. Now, it is true that in the subsequent years both you and your son altered at your convenience

(Testimony of Max Jeffrey Kuney, Sr.)

the amount you retained in the capital account, that is true, isn't it?

A. The fact is—that is not true.

Q. Please explain. Please explain, if you will, please, sir.

A. Oh, yes. As I stated before, in later years the partnership's interest was in fixed assets.

Q. I am having difficulty hearing you.

A. In later years the partnership's interests were in fixed assets.

Q. By "later years" you mean after their interest in the corporation was extinguished, is that what you mean by "later years," 1953 and on?

A. Yes, in later years, yes. And there was continual trading [91] done in fixed assets.

Q. And continual trading by whom?

A. By the partnership buying and selling machinery and equipment as needed, not in a trading business, but the construction business. More equipment would be bought. Other equipment would be sold, and every one of those sales changed the total investment in fixed assets. Every purchase and every sale was a natural thing that followed and a necessary thing. That is the way the investment changed and not at our convenience except as you might say, that the machinery was bought at our convenience for use at the time.

The change in investment followed through the purchase of other machinery and other equipment and the sale of something that was old.

Q. I should like to inquire into that, Mr. Kuney,

(Testimony of Max Jeffrey Kuney, Sr.)

and come back a moment later to the capital account which was really the question I was asking about now. But this area you mentioned, trading or whatever the expression is, in these old assets——

The Court: You are going to pass that for the time being?

Mr. Biggins: I am going into this very thing he brought up. That is what I want to inquire into.

Q. (By Mr. Biggins): The partnership did rent or lease [92] something—the partnership, of which the kids were members, did lease or rent the fixed assets to the corporation? That is clear?

A. That is correct.

Q. And it is the dealing in those fixed assets you were just talking about? A. Yes.

Q. Now, then, when on the books of the family partnership—the assets being rented to the corporation on these books has completely depreciated—are you with me, sir? A. I think so.

Q. You do understand, not being an accountant, you do understand some bookkeeping and accounting, your having been a bookkeeper?

A. I understand what you say, yes.

Q. The corporation was using fixed assets. Then on the books of the family partnership they had been completely depreciated? A. Yes.

Q. Did the corporation pay rent to the partnership? A. In the year 1952?

Q. Any year. The answer is no?

A. The answer is yes, in certain years.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. Oh, and what was the determining factor—certain years? [93] What years, Mr. Kuney?

A. In the years late in '53 and late '54, as I previously testified, that entire matter of rental was recomputed and determined by Revenue Agent Mr. Carney, and accepted by us, and that is the determination that we are with now, sir. As to the later years, why, there is another question or another answer.

Q. As I understand your explanation, then, Mr. Kuney, it was recomputed—for whatever the reason, it was recomputed at a later time and retroactively applied?

A. By Mr. Carney, and the income tax returns were amended.

Q. And you made the amount of rent being paid by the corporation to the partnership dependent on tax considerations?

A. I made it dependent on what he recomputed it, sir. He just merely changed our method without really materially changing our amounts, and that is a fact.

Q. Which was not done in the case of the other partnerships with Lloyd and Greene?

A. It was done in connection with the rental of all machinery and equipment, as I remember it now. It is a total matter, that is the total rent that the corporation paid to the partnership was changed slightly from our original tax return by an examining officer's findings, which we accepted and have

(Testimony of Max Jeffrey Kuney, Sr.)

long since made entries to [94] correct it, and it is a matter that we thought was final.

Q. You settled out with your other business partners, Johnson and Greene, at the end of every business year? That is true, isn't it?

A. I don't understand "settling out."

Q. You determined your profits and losses and had your distribution at the end of every business year when the books were closed? That is true, isn't it?

A. Yes, at that time.

Q. But that didn't apply between the corporation and the family partnership? That is also true, isn't it?

A. No. The corporation happened to be a fiscal year, sir, instead of a calendar year and another thing that can't be avoided. It would be done in May. We had at that time a fiscal year corporation, a calendar year partnership, and there was varier dates. But always our profit and losses are determined and rendered on the books as soon as we can do them at the end of the tax year even if that happens to be May, or if it is June or July, or if it is December.

Q. But it is true in 1958 the corporation was still discussing and trying to decide how much, if any, rent should be paid by the corporation to the family partnership for '54 and '55, that is true?

A. That is a matter—— [95]

Q. As indicated in the minutes?

A. Yes, sir, certainly. Each year it is a bargaining between the two.

(Testimony of Max Jeffrey Kuney, Sr.)

The Court: No, you haven't followed the question, Mr. Kuney, and I want you to answer the precise question, please. Go ahead.

Q. (By Mr. Biggins): In 1958, about that time, 1958, the corporation was still discussing and trying to determine what rent, if any, should be paid by the partnership to the corporation for '54 and '55, that is true, isn't it?

A. If you refer to the minutes—can you refer to something?

The Court: Are you able to recollect it without the minutes?

Q. (By Mr. Biggins): You don't know?

A. In the year 1958——

The Court: If you say "No," we will find it. The question is, do you know?

The Witness: No, I do not know that.

The Court: All right. Go ahead.

The Witness: I don't know that.

Q. (By Mr. Biggins): Would you look with me, please, sir, I believe it is the same minutes you had before, "The chairman next pointed out that the original corporate [96] stock—" and read what we read about—read what we had said about had been incorrectly issued.

The Court: He lost that place. You had better find it again.

(Whereupon, Mr. Biggins approached the witness.)

Q. (By Mr. Biggins): Is that '57 or '58? This

(Testimony of Max Jeffrey Kuney, Sr.)

minute is February 7, 1957, isn't it, Mr. Kuney?

A. Yes, that is the date.

Q. And over on the page right above where we said the partnership incorrectly issued, do you see the language, "it was discussd—" and they were talking about this was not a tenable position——

A. May I find it, please?

The Court: Try and orient him on the place each time.

Mr. Biggins: I thought I had pointed it out to him.

The Court: Give him the line number.

Mr. Biggins: There is no line number here.

The Court: Well, count it.

The Witness: I find the place now.

The Court: All right. Go ahead now. Read what you wanted to read.

Q. (By Mr. Biggins): "——pending clarification there was discussed that rental charges on fixed assets for [97] year——"

The Court: He is not with you for some reason.

A. You are not reading where you put the ruler.

The Court: About how far down the page?

Q. (By Mr. Biggins): That is right where I put the bookmark.

A. Will you start at the beginning?

Q. Oh, certainly. Try and keep your place, Mr. Kuney, so that we can get on with it.

A. I will.

The Court: All right. Go ahead.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. (By Mr. Biggins): Well, starting at the beginning of the paragraph, sir,

“The next item of discussion advanced by the chairman concerned the matter of payment of rental by the corporation to the Kuney family partnership for fiscal years 1955 and 1956 and interest on the partner’s investment in those fixed assets.”

A. Yes.

Q. “It was discussed that the examining Internal Revenue Agent had taken the position that the fixed assets in Seattle were, in effect, transferred to the corporation.” A. Yes.

Q. “It was discussed that this was not a [98] tenable position, and the corporation has protested accordingly, however, pending clarification it was discussed that rental charges on fixed assets for years 1955 and 1956 should be held in abeyance until the treasury’s position on this question was better known.” A. Yes.

Q. And that is exactly what you did, isn’t it?

A. Oh, yes.

Q. And you resolved,

“Resolved that for the time being the Kuney family partnership shall not charge the corporation rental for the use of its fixed assets fiscal years ending 1955 and 1956——”

A. (Interposing): We just wanted to find out what to do until a certain time.

Q. And if you will look at the next minute, we were still having that same trouble in 1958, as I stated, as you remember?

(Testimony of Max Jeffrey Kuney, Sr.)

A. No, I don't remember.

Q. Where is the next minute, just following that or somewhere else?

Mr. Biggins: Never mind.

A. I notice we are having trouble with the examining officer's finding at this time, but I don't remember [99] it kept on into 1958.

Q. Now, on the salaries, Mr. Kuney, we have discussed that there was some buying and selling of fixed assets? A. Yes.

Q. Do you recall that? A. Yes.

Q. And, of course, when those fixed assets are sold, capital gain was claimed and allowed, do you recall that? A. In some cases, yes.

Q. And it is also true that when that capital gain was allowed, you and your son insisted that your salary be distributed in the form of capital gains? That is also true, is it?

A. No. What was done was done. But I don't recall any insistence——

Q. Well, are you familiar with the accounting documents which your bookkeeper, I believe Mr. Peterson, and your accountant, Mr. Bowen, referred to as the "Bible"?

A. I referred to it as the Bible, and I should be, I wrote it.

Q. And what do you understand that I mean by the word "Bible"?

A. Well, possibly it is something that some people don't read, I don't know. [100]

Q. Now, I mean here——

(Testimony of Max Jeffrey Kuney, Sr.)

The Court: What papers in this case—related to this case?

A. Why, there is simply a series of journal vouchers numbered one to a certain further place. I know of no reason to describe it as “Bible.” But I know what you mean.

Q. But we did establish that you are the one that wrote it? A. I did write it.

Q. All right. Do you recall, on Page 4—and may I call it the so-called “Bible,” where you wrote in 1957 under “Partnership Agreements,” the words,

“The partners of Kuney family partnership agree that effective January 1, 1955, and until this agreement is changed in writing:

(1) Active partners Max J. Kuney and Max Kuney, Jr., shall receive total compensation \$10,000 per year from partnership income to be divided equally between them and that the remaining income shall be distributed in proportion to each partner’s capital investment in the partnership.

(2) Active partner’s compensation each year shall be taken entirely from partnership [101] capital gains if such are sufficient, with the balance to be taken from partnership ordinary income only when such is sufficient and capital gains are not sufficient.”

Do you recall that?

The Court: Do you remember writing that?

A. I am certain I wrote it. He is reading from what I wrote.

Q. (By Mr. Biggins): You wrote it in 1957?

(Testimony of Max Jeffrey Kuney, Sr.)

A. Whenever it was dated is when I wrote that.

Q. To apply retroactively to 1955?

A. If it so states.

Q. All right. And this is not the first time mentioned in the writing that partnership income is to be divided equally between them—that is the first time any distribution of income is mentioned in writing, that is true, isn't it?

A. No, sir, that is not true.

Q. What written documents do we have before this time that set forth the manner in which the income earned by the partnership will be distributed to the trust and the active partners?

A. I can't remember the exhibit number, it was passed to the jury, and it is dated February 11.

Q. Do you mean the trust agreement? [102]

A. Sir, excuse me?

Q. Do you mean the trust instrument or the agreement?

A. I don't remember the exhibit number.

The Court: Get the ones that were passed to the jury. They are right there.

A. It is not the trust instrument, it is the other paper.

Q. (By Mr. Biggins): Do you mean the instrument, in other words, which you signed,

“The undersigned hereby agree that effective January 1, 1952, total Max J. Kuney income shall be distributed annually between Max J. Kuney and trust dated——”

That is the instrument you mean, Exhibit 24?

(Testimony of Max Jeffrey Kuney, Sr.)

A. Yes.

Q. “——Total Max J. Kuney income shall be distributed annually between Max J. Kuney and trust——”? A. Yes.

Q. Where does it say on that instrument how much will be distributed to each?

A. Where it says,

“——provided by the rules of law then effective for family partnerships and in conformity with the provisions of said trust.”

Q. And pursuant to that may I then understand, Mr. Kuney, that in some years you got 80 per cent of the income, [103] in some years you got as little as 20 per cent of the income, and in some years you got just exactly the same amount, all pursuant to this Exhibit 24?

A. All pursuant to that and pursuant to the necessity—it was if those are the percentages.

Q. And the necessities, as you discussed them and determined them long after this instrument was entered into, necessities considered and discussed long after this instrument was written and entered into?

A. I do not agree. At all times the interest was computed in accordance with the percentage of capital interest held by the partners, and that is determined by the actual existence of such things as trucks, tractors, land and buildings and matters of that kind.

Q. Would you recall, Mr. Kuney, that in 1952, was the very first return on which you reported ap-

(Testimony of Max Jeffrey Kuney, Sr.)

proximately 42 per cent of the profit, 41.78, and John R. about eight per cent, would you recall that, sir?

A. Yes, I can recall that would be about it.

Q. Would you recall subsequently in your Bible entry for 1956 that you didn't write until January 7, 1957, that you entered your income as around 10 per cent, and your trustee John R. was 40.92? Would you remember that?

A. That could be entirely possible as his interest changed.

Q. But even though that was in the Bible, when we came to [104] the income tax return, we changed it then to 24.73? Would you remember that?

A. I would remember that the changes were made as the—as the capital interest changed always, and I think they are always correct.

Q. And tell me, Mr. Kuney, and this is my final question, what representative or what voice did the grandchildren have in changing the capital interest, any at all, besides you?

A. Assets were bought as needed.

The Court: Please answer this question.

A. What voice did the grandchildren have?

The Court: If you don't understand, he will repeat it or explain it. But please answer the question. Go ahead.

The Witness: Please ask me again.

Q. (By Mr. Biggins): You say, sir, and I don't mean to make——

The Court: Just put the question.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. (By Mr. Biggins): You say these changed as the capital interest changed. The capital interest changed sometimes even two years after the year was closed, the capital interest was changed by you.

A. It was dated back to put in an amended tax return, which [105] was required by the very necessity that our books were changed by examining officers, and we might even foresee the necessity of doing that at any time. Those things must be done.

Q. I am now asking you about the other partners in the family partnership. What right or voice or what representative did Jeff, Caroline, and John R. have in changing this capital account?

A. Their trusts have the rights.

Q. Who is their trust?

A. The children——

The Court: Just answer the question.

A. The trusts have the rights.

Q. (By Mr. Biggins): Who is the trustee for Jeff and Caroline? A. I was.

Q. And who was the trustee for John R.?

A. Junior.

Q. And who executed—typed on their own typewriter Exhibits 24 and 25 as you stated a moment ago? A. The initial is "F. P."

Q. Who prepared and presented Exhibits 24 and 25, as you testified a minute ago?

A. I dictated them. I wrote them, typed by some one else.

Mr. Biggins: That is all. [106]

The Court: Redirect.

(Testimony of Max Jeffrey Kuney, Sr.)

Redirect Examination

By Mr. Toole:

Q. Mr. Kuney, directing your attention to the stock ownership of the corporation, you testified on cross-examination that the stock of the corporation had been originally issued to the partnership?

A. Yes.

Q. And that in 1957 you testified you corrected what had been——

The Court: I don't think you should summarize the testimony, because you are going to get into difficulties that way. Let us have just redirect examination now, please.

Q. (By Mr. Toole): The question is complicated by withdrawing the stock from the partnership and turning it over to you and your son individually. Did that hurt the trust?

A. No, it turned out to be a benefit to the trusts.

Q. How?

A. As stated, the corporation had a bad year, and the trusts continued to profit, but that was not a thing that was foreseen at the time.

Q. Did the corporation ever pay any dividend to the [107] partnership? A. No.

Q. There was no income being earned by the partnership from the ownership of the stock of the corporation? A. None.

Q. So that even while the corporation stock was owned by the partnership, the children weren't receiving any share of the profits?

(Testimony of Max Jeffrey Kuney, Sr.)

A. That is what I said, they never did receive any profits or losses.

Q. From the corporate operation?

A. Regardless of the fact, they owned stock and there was no dividends or profits, nothing happened.

Q. What happened to your capital account investment in the partnership when the stock was withdrawn by you from the partnership? Did it increase or decrease, your personal capital account?

A. May I have a moment? That is a rather involved accounting question.

The Court: Well, the first part of the question, what happened?

The Witness: Book entries were made.

Q. (By Mr. Toole): What happened to your capital account investment in the partnership, did it increase or decrease when the stock was withdrawn by you from the [108] partnership?

A. I am sorry, sir, I don't understand.

The Court: Don't lead now, keep it nonleading and suggestive. Let him answer himself.

A. I regret, I don't understand. I know the book entries were made. If I could see them, I would know, but at this time, after thinking longer, I believe I can answer your question, if I may.

Q. (By Mr. Toole): Please do.

A. It was just changed from one investment to another, nothing happened as to increasing it over all. Whatever it was taken out from and put into, it would just merely be reflected by a book entry.

Q. Did the withdrawal of the corporate stock

(Testimony of Max Jeffrey Kuney, Sr.)

by you and your son or the transfer to your personal account affect the profit-sharing ratio in any way of the family partnership?

A. Well, as it turned out, it improved the profit-sharing ratio because the corporation didn't make money, but the position of the family partnership was improved.

Q. How was it improved?

A. Well, they continued to make profit, whereas, the corporation lost, and if they had an interest in it, they would have lost with it.

Q. Directing your attention to the corporate minutes, and [109] this is the minutes of February 7, Exhibit Q—directing your attention to Page 2 of the minutes of February 7, 1957, Page 2, the paragraph that was read earlier on the withholding of rental income for the fiscal years 1955 and 1956—

A. (Interposing): Yes, sir.

Q. I believe Mr. Biggins didn't read the complete wording of the paragraph? A. No.

Q. In the center of that paragraph do you find the words, "Following this detailed discussion, on motion duly made, seconded and unanimously carried the following resolution was adopted——"?

A. Yes.

Q. And doesn't it go on to say,

"Resolved that for the time being the Kuney family partnership shall not charge the corporation rental for the use of its fixed assets fiscal years ending 1955 and 1956 but that following clarification of the Internal Revenue department's position on the

(Testimony of Max Jeffrey Kuney, Sr.)

matter of the Seattle assets proper rental may be subsequently charged retroactively and, be it further resolved, that the corporation shall pay interest on the partner's investment in fixed assets during the years in [110] question at the interest rate the corporation paid to the bank for borrowed money during those years."?

A. It so states.

Q. Were rents ever paid by the corporation to the family partnership for the years 1955 and 1956?

A. Yes.

Q. Were adjustments made or not made with the Internal Revenue Service regarding these rentals?

A. They were made.

Q. And after the determinations had been made, did you or did you not credit the partnership with rent?

A. We did credit it after the determination was made.

Q. Were amended income tax returns filed, or were they not?

A. They were filed.

Q. Reflecting this income?

A. And taxes were paid.

Q. There has been reference to the "Bible." When did you first hear of the word "Bible" in connection with these journal entries?

A. Last Saturday—day before, whenever it was—Saturday of this week.

Q. Was this a rather irreverant designation by the office as far as you were concerned? [111]

A. I don't care what they call it. It was the title used for some reason by the government.

(Testimony of Max Jeffrey Kuney, Sr.)

Q. Why was it necessary for you in February of 1957 to make adjustments adjusting entries affecting the capital account for the years 1955 and 1957?

A. Because Revenue Agents had been in our office for days, and we were about—for the first time appeared to have our tax returns changed to any effect, and I come over to see what it was about, and there I found them.

Q. Why was the adjustment—Strike that.

What matters had arisen which required adjusting entries?

A. All the things that they had done changing our records, changing our income.

Q. By “they,” whom do you mean?

A. The Internal Revenue.

Q. Could you describe specifically who had made these adjustments?

A. Yes, the Bible specifically describes it under oath.

Q. Who was it? A. What?

Q. Who made these adjustments? What Revenue Agent made them? A. Mr. Carney.

Q. The gentleman sitting over there—— [112]

Mr. Biggins: He was the gentleman sitting here. He has left the courtroom momentarily.

Q. (By Mr. Toole): What was the nature of these assessments? Could you describe for the jury some of the more important factors that required adjustment?

A. Well, the findings proceeded at great length

(Testimony of Max Jeffrey Kuney, Sr.)

to change things to very minor amounts through all the years. But in addition to that, the findings found—what stated in the—as issues as to why the income of the trusts should be taxed to me instead of to the recipient of the income, and the so-called Bible states and quotes by page and line from the examiner's order findings and is a complete—or is my, rather, statement in connection with those findings and the entries that were made in the books. They are very—rather complete, I believe, general vouchers that completely describe and quote and refer to various places, and the entries are quite apparently necessary, because, as it says, "E. O. F.," examiner officer's findings for certain years, page so and so, line so and so.

Q. I believe you have answered the question.

Let me ask you this question, did the examining agent ever find any unreported income on your books?

A. Never in all the years we have been in business.

Q. Did the examining agent find any deductions that you [113] should not or that were——

Mr. Biggins: If the Court please——

The Court: Immaterial. There is no contention about that in the case, so it is irrelevant and immaterial.

Q. (By Mr. Toole): Is it true or not true that these adjustments were a question of timing as to when deductions should be taken and who was taxable on them, how much rental?

(Testimony of Max Jeffrey Kuney, Sr.)

A. The important thing was whether it was taxable to one party or another, but incidentally throughout the thing requiring all these intricate changes which were very minor, because I'd say they were less than one per cent of the total, \$4,200, but minor in percentagewise. It required much book-keeping, much changing, much amending of tax returns, and incidentally, much confusion to people trying to run a business.

Q. Is it true or is it not true that always the profit has been divided according to the capital interests of the trusts?

A. Always. That is true.

Q. I don't mean trusts, I mean all of the partners?

A. Never in any other fashion whatsoever to my knowledge, and my knowledge is complete. Never in any other manner, except the surplus that the trusts have which is left [114] over after they have—after all the assets have been bought, draws interest. Now, that is also an added amount. Their source of income is from rent and interest on their investment, and the corporation pays it, and it has been handled that way. I don't know whether it is correct, may I explain the word——

The Court: Well, you will have to wait for a question from your counsel, Mr. Kuney. Go ahead.

The Witness: That one word "incorrectly."

The Court: All right. Tell us what you want to about it.

A. I meant it just only in the accounting sense.

(Testimony of Max Jeffrey Kuney, Sr.)

I think it is incorrect to issue corporate stock to a group of partners. It should be issued individually, one, two, three, four, five, six, like General Motors does. That is all I meant by "incorrectly." It is just a matter of opinion, an accounting concept. It is easier to think of it that way, and I believe I would again say that issuing it individually is correct, and the other way is cumbersome and incorrect. That is the meaning of the word "incorrect" in that topic.

Mr. Toole: That is all.

The Court: Recross.

Mr. Biggins: Two further questions. [115]

The Court: Go right ahead and we will finish with this witness.

Recross-Examination

By Mr. Biggins:

Q. You do recall, Mr. Kuney, writing this letter to your son Junior about the money that his mother needed for the operation—for her parents? You do recall that occasion?

A. That is one letter I do remember very well, sir.

Q. And I believe that is Exhibit 33, Mr. Grant. Do you recall my question, Mr. Kuney? Do you recall that in that—is that the letter?

A. No, this is a rental agreement.

Mr. Biggins: It is Exhibits 26 and 27. If the Court please, to save time, may we show him——

(Testimony of Max Jeffrey Kuney, Sr.)

(Whereupon, certain documents were handed to the witness.)

Q. (By Mr. Biggins): This is the very first letter on the very first distribution under these trusts, that is true, isn't it, December, 1952, Exhibit 27?

A. February 11, 1952, is the very first document directing anything about it——

The Court: The first letter concerning [116] a distribution.

A. First letter concerning distribution, yes, it is, sir.

Q. (By Mr. Biggins): And the concluding paragraph, after we took care of Lorraine and her parents who have been ill, the very last paragraph,

“If, as trustee, I deem it advisable to make any further distributions from the 1952 income of the trust to other persons eligible to receive such distribution I will issue instructions prior to the end of the year 1952.”

A. That says that, yes.

Q. You would advise prior to the end of the year 1952? A. Yes.

Q. All right. Now, distributions were made for 1952 after this letter, weren't they? A. Yes.

Q. The \$10,000 you mentioned for Max and Caroline? A. Yes.

Q. And around \$18,000 for John R.?

A. Yes.

Q. And those distributions were made after the tax consequence were determined in April of 1953?

(Testimony of Max Jeffrey Kuney, Sr.)

A. Whenever they were made. I don't recall.

The Court: Well, don't you recall that they were made at that time? [117]

The Witness: No, I don't think they were. I don't remember the time that we filed tax returns, and we usually know tax consequences long before even the end of the year because that can be readily computed. We have a pretty good idea of what we are going to make.

Q. (By Mr. Biggins): You would have no doubt that the date on the books would be accurate?

A. I have no doubt of that. The date that is indicated on any original journal voucher would be correct.

Q. And my last question of this battery is, is it true, then, that you did issue instructions prior to the end of 1952, as you said you would do, if further distributions of '52 income were to be made. In a word, sir, you didn't?

A. I probably didn't. I said I would do it before the end of 1952, but I might have done it a couple of months later.

Q. You mentioned, Mr. Kuney, that profit distributions were made only in accordance with capital interest. Did I recall that testimony correctly, sir?

A. With the exception of these special beneficiaries.

Q. Now——

A. (Interposing): No exceptions, they were made to the trusts that way, no exceptions. [118]

(Testimony of Max Jeffrey Kuney, Sr.)

Q. But in addition to your recorded capital account on the books, you had what you call a capital surplus account, didn't you?

A. I believe that is a correct name.

Q. And your son had a capital surplus account?

A. Yes.

Q. And you controlled the amount that would be in that capital surplus account, didn't you?

A. No.

Q. Who did?

A. The amount of income, we controlled it. I just can't create it with a pencil.

Q. You did not? A. No, I did not.

Q. Could you explain for us, Mr. Kuney, why for the Bible in 1955 that your interest in the income was 16.99, John R.'s income was 33.66, and that for the amended return which you filed 4-14-58, your share of income was 28 per cent and John R.'s was 22.4? How do you explain that, Mr. Kuney, if your distribution was always in accordance with capital interest which you could not control?

A. I believe I can explain that quite easily.

Q. Please do, sir.

A. You state that in one original return it was one way and [119] on an amended return it was another way, did you not?

Q. This is the Bible? A. What?

Q. This is the Bible—subsequent to the Bible you prepared an amended return—so I might state this, this is in 1957—this is in 1957 while we are still trying to figure out what happened back in

(Testimony of Max Jeffrey Kuney, Sr.)

1955, and in 1957 concerning 1955 in your Bible you say 17 per cent, in your amended return you say 28 per cent. In one your son has more and in the other your son has less? A. Yes.

Q. Its determination is all in accordance with capital interest which you do not recall?

A. Do you want an explanation?

Q. Yes, we want you to explain.

A. First it is an amended return. Bear that in mind. That means there is a change of figures by necessity. That is enough explanation.

Q. (By Mr. Biggins): That is the only one you care to give? A. That is sufficient.

Mr. Biggins: That is all.

The Court: Is there anything further from this witness?

Mr. Toole: That will be all.

The Court: You are excused, Mr. Kuney, and you [120] may step down.

(Witness excused.)

We will recess now, ladies and gentlemen, until tomorrow morning at 9:30. Would you please keep in mind my admonition. I hope you have a pleasant and restful evening and that you come back in the morning refreshed and ready to carry on with this case. Good night.

(Whereupon, at 4:30 o'clock p.m., the court recessed.) [121]

Tuesday Morning

(Whereupon, on Tuesday, November 22, 1960, at the hour of 9:30 o'clock a.m., all counsel heretofore noted and the jury being present, the following proceedings were had, to wit:)

The Court: Go ahead, please.

Mr. Harmon: Mr. Henry, please.

JAMES M. HENRY

called as a witness on behalf of the Plaintiff, being first duly sworn, was examined, and testified as follows:

The Clerk: Would you state your full name and spell your last name?

The Witness: James M. Henry, H-e-n-r-y.

Direct Examination

By Mr. Harmon:

Q. Where do you reside, Mr. Henry?

A. Boise, Idaho.

Q. And what is the name of your business firm?

A. Henry, Rust & Company.

Q. And what business are you engaged in?

A. General insurance and sureties, specializing in contract bonds. [122]

Q. And what company or companies do you represent?

A. We represent some twenty different insurance companies over the United States.

(Testimony of James M. Henry.)

Q. Would you explain briefly what the insurance business is?

I am not sure that the jury knows any more about it than I do.

A. Whenever a contract is let by any governmental agency, starting with the federal government down through the states, city, county, a requirement of the contract is that the contractor provide a surety bond wherein the owner or the government, as the case may be, is guaranteed that the contract will be faithfully performed and that all labor and material men will be paid. That is a must, and the surety becomes a third party of all contracts.

Q. Now, what information must the surety know about the contractor before he is willing to issue a surety bond for the contractor?

A. Well, it is very essential, inasmuch as this is a direct financial guarantee, that we have particularly three things that we are interested in; first, we want to know the character of the party we are bonding; secondly, we want to know, does he have the capacity and the equipment and the plant to do the particular job which he is [123] contracting, and the third thing is he must have, of course, capital.

Q. How long have you known Max J. Kuney, Sr.?

A. About twenty-five years.

Q. How long have you done business—surety bond business with the Max J. Kuney Company?

(Testimony of James M. Henry.)

A. We have handled all of the Max J. Kuney Company business for the past twenty years.

Q. When did you first find out about the Kuney family trusts and their relationship to the Kuney family partnership, Mr. Henry?

A. Off and on for a number of years. Max, Jr.—Max Kuney, Jr., and myself had discussed trusts of various kinds and phases.

Q. When? A. What?

Q. About when was that, if you recall?

A. The first time I knew about the family trusts was probably in the latter part of January, 1952. The reason I can recollect that is that over the period of years there was always a custom established by the Kuney organization that I come in some time right after the 15th of January and work out an insurance audit for the preceding year in order that they could close their books and get their financial statement to the bonding company and to the [124] various states that require the statement for license purposes. I can definitely recall this one because I was in Spokane making my annual audit when Max, Jr., showed me the tentative draft of this family partnership.

Q. Was this trust document signed, do you recall?

A. It was unsigned, as I recall. It was a rough draft.

Q. Did you or did you not notify all the surety companies you represent of the fact?

A. At that time there was one particular surety

(Testimony of James M. Henry.)

company that was underwriting suretyship for the Kuney organization, and it was discussed with them.

Q. And incidentally, how do you set up a bond when a company bids a job?

A. Well, most of that is worked out on this basis, when they file the statements with the companies as soon as they are published, and then from time to time as the project comes up, these matters almost always are discussed over the telephone, and we are given the authority to go ahead then and provide the necessary bonds for the contracts.

Q. How many companies, for instance, for the Kuneys would you be dealing with?

A. We only use one surety company for the prime contract. The surety itself then in turn sometimes would use as many as fifteen or twenty companies as re-insuring [125] organizations.

Mr. Harmon: I think that is all.

The Court: Cross.

Cross-Examination

By Mr. Biggins:

Q. Your last name is Henry?

A. That is right.

Q. I take it, sir, you first found out about this very clearly in your mind in January, 1952?

A. That was sometime between—after '51, between '51 and '52.

(Testimony of James M. Henry.)

Q. It was after that that you advised your underwriting companies about this?

A. That there was such a partnership set up, that is right.

Q. Because it was important?

A. That is part of it, and it was signed—our applications were always signed by the Kuneys, Max and his father as partners.

Q. But it is important to underwriting companies to know just who the partners are?

A. That is right.

Q. And also you advised the underwriting companies that Mr. Claggett was a partner, did you?

A. Oh, yes, a special partner. [126]

Q. What agreement—what partnership agreement did you see at that time that showed Mr. Claggett as a partner?

A. What was that?

Q. You said you saw the agreement?

A. I saw the trust agreement.

Q. Was Mr. Claggett's name mentioned thereon?

A. No.

Q. Where did you find out about Mr. Claggett?

A. Well, Mr. Claggett—knowing the organization, I knew that Mr. Claggett was a special partner.

Q. And still is?

A. And still is.

Q. Being close to the organization and knowing Mr. Kuney, you still know that?

A. As far as I know, unless it has been changed within the last four or five months.

Q. And being important knowing who the own-

(Testimony of James M. Henry.)

ers of the company are, Mr. Henry, you, of course, do subscribe to Dun & Bradstreet reports?

A. Oh, certainly.

Q. And when you read that report—you did get the 1953 report, you remember that?

A. I don't recall.

Q. You get it every year?

A. The company gets that, yes. I don't get them particularly. [127]

Q. When you got that report and when you saw the list under "partners," it was only Claggett—that Max J. Kuney, Jr., was a partner of Claggett and made no mention of the trust, and that surprised you, didn't it?

A. No, it didn't.

Q. You weren't subpoenaed from Boise?

A. What is that?

Q. You weren't subpoenaed by them to come over here?

A. No, sir.

Q. And you still have the insurance business?

A. Yes, sir.

Mr. Biggins: Thank you very much for coming all the way over here.

The Court: That is all, Mr. Henry. You may leave whenever you wish.

(Witness excused.) [128]

EDWARD A. COON

called as a witness on behalf of the Plaintiff, being first duly sworn, was examined and testified as follows:

The Clerk: Would you state your full name and spell your last name?

The Witness: Edward A. Coon, C-o-o-n.

Direct Examination

By Mr. Harmon:

Q. What is your address, Mr. Coon?

A. Spokane, Washington, 1215-19th Avenue.

Q. By the way, Mr. Coon, are you not here under subpoena?

A. I am here under subpoena.

Q. By whom are you employed?

A. By the Seattle-First National Bank in the Spokane and Eastern Branch.

Q. What position?

Q. I am a vice-president.

Q. In what department?

A. In the loan department, commercial loan department.

Q. And how long have you been employed in this capacity?

A. I have been in Spokane eleven years.

Q. Have you been in that position?

A. Yes, in that department all the time. [129]

Q. In your position as vice-president of the commercial loan department of the bank, have you

(Testimony of Edward A. Coon.)

had any occasion to do business with Max J. Kuney, Sr. or Jr., or Max J. Kuney Company?

A. I have.

Q. For how long?

A. Oh, more than ten years.

Q. Tell us briefly what your duties have been with respect to the loans made by the Max J. Kuney Company?

A. Well, I represent the bank in dealing with the Kuneys. I have handled their accounts, and credits are arranged through myself for the bank.

Q. Do you or do you not know much about the operations of the business in your job?

A. Well, that is my job to be acquainted with the Kuneys' affairs.

Q. Now, were you here yesterday, Mr. Coon?

A. No. Well, I came over on the airplane last night.

Q. You were not here in court?

A. Oh, no.

Mr. Harmon: Mr. Bailiff, will you show him Exhibits 1 and 2, the trust agreements?

(Whereupon, certain documents were handed to the witness by the Bailiff.)

Q. (By Mr. Harmon): Now, Mr. Coon, were copies of each of [130] those trusts signed by the Kuneys delivered to you or to the bank?

A. We have copies of each of these trust agreements.

Q. Do you recall exactly when you got them?

(Testimony of Edward A. Coon.)

A. Well, I first heard of the trusts in the early spring of 1952. I am sure that we had copies of the agreements before the end of the year 1952.

Q. During those three years, '52, '53, and '54, was the bank receiving annual statements from the Max J. Kuney Company?

A. That is right, absolutely.

Q. What was done with these financial statements when they were received?

A. Well, we would really scrutinize the statements and verifying all of the assets and also the liabilities. In fact, our credit, in addition to the responsibility of the management, was based on the financial statements.

Q. Did the statements or did they not clearly reveal the existence of this trust as partners in the family partnership?

A. The 1952 statement, December 31, 1952, statement indicates the trusts are listed there.

Q. Do you recall when they were signed by CPA's? A. They were.

Q. Would that mean anything to you? [131]

A. Well, I should say so. We would have insisted on them.

Q. What is the status of the Kuney Company account with the bank now? How much is owed?

A. Nothing is owed at the present time.

Q. When did you first meet me, Mr. Coon?

A. I can't recall whether it was last Wednesday or Thursday of last week.

Q. Did you at my request examine all of the

(Testimony of Edward A. Coon.)

bank records with respect to the Kuney account to refresh your recollection?

A. I sure did. You bet I did.

Q. Do you or do you not know how the Max J. Kuney Company handles its affairs with respect of the purchasing of equipment, supplies, and so forth?

A. Well, I am not sure that I know how you mean that. I think they buy where they can get the best price.

Q. No, I don't mean from whom, but cash or credit?

A. Oh, they pay for everything that they buy. I have never known them to buy anything on contract, it is always cash.

Q. Do either you or the bank have any interest at all in the outcome of this lawsuit?

A. Not at all.

Mr. Harmon: That is all.

The Court: Cross. [132]

Cross-Examination

By Mr. Biggins:

Q. May it please the Court, before the two questions which I do have to ask, I should like to clarify, and implying no impropriety at all, you did state you were subpoenaed to come over here?

A. That is true.

Q. May I inquire, where did you get your subpoena?
A. In Seattle.

Q. I see. You came over here voluntarily to get

(Testimony of Edward A. Coon.)

the subpoena? A. That is true.

Q. Your answer before wasn't complete, then, was it? Let us put that at rest, your answer before was not complete, was it?

A. I thought I answered the question.

Q. All right. Now, I was a bit perplexed, you did say they purchased everything by cash?

A. To the best of my knowledge.

Q. But yet the bank loaned them money? They loaned them money for what?

A. Well, for purchases.

Q. I see. A. For payrolls.

Q. So I may be clear on that, you have made periodic credit [133] investigations of this company? A. I should say so.

Q. And you do loan money to them?

A. That is true.

Q. And you accordingly know that the partnership has pledged and/or made available to the corporation its fixed assets? A. That is right.

Q. One last question. Please think carefully and try to recall back the 1952 financial statement which you said you examined. A. Yes.

Q. You said on that financial statement it indicated that these kids were partners, these trusts?

A. That the trusts were set up.

Q. Think back carefully and accurately and precisely. Isn't it true that the word "partnership" was never used on that financial statement and it simply said, "Max J. Kuney and trusts" under the

(Testimony of Edward A. Coon.)

liability and capital account? That is really what you meant to say, wasn't it?

A. No, I don't believe so.

Q. Do you have the financial statement with you now, sir, that showed them as partners and not capital accounts, sir, not capital accounts, as partners of the business? [134]

A. Well, that was my understanding.

The Court: No, that isn't the question he asked you. He asked, do you have the financial report that shows that?

The Witness: No, I don't think so.

Mr. Biggins: That is all. Thank you.

The Court: You are excused.

Mr. Harmon: Could I have a question on re-direct examination?

The Court: Yes.

Redirect Examination

By Mr. Harmon:

Q. Mr. Coon, why did you insist on being subpoenaed?

A. That is the custom of our bank and when you are speaking for the bank, to be subpoenaed.

Q. The inference that you are here voluntarily is not true?

A. That is right. In fact, I was told I would be subpoenaed in Spokane.

Mr. Harmon: Will you show him Exhibit 30, please?

(Testimony of Edward A. Coon.)

(Whereupon, a certain document was handed to the witness by the Bailiff.)

Q. (By Mr. Harmon): Turn to Page 14, please, Mr. Coon. A. Yes. [135]

Q. The last subhead on that page, would you read it, please?

A. The capital account—the partners' source of 1952 profit and net worth.

Q. And what are the partners shown underneath that heading?

A. Oh, well, the partners would have been Max J. Kuney and child, Max Kuney, Jr., and children, Lloyd W. Johnson and children, and C. S. Greene.

Q. And Max J. Kuney and child and Max J. Kuney, Jr., and children, did that clearly mean to you these trusts?

The Court: Well, it has not been shown that this witness ever had these income tax returns at the time.

Mr. Harmon: This is not an income tax, if your Honor please.

The Court: It is listed so on the exhibit list.

The Witness: No, this is the audited statement.

Q. (By Mr. Harmon): Would you turn to the front of Exhibit 30 and read and tell us what it is?

A. Exhibit what?

Q. Thirty.

A. That is the Max J. Kuney Company financial statement.

The Court: Very well.

(Testimony of Edward A. Coon.)

Q. (By Mr. Harmon): That is the document you were testifying [136] about? A. Yes.

Q. You said you got it at the end of the year and it revealed the existence of the trust?

A. That is right. We have these back for many years, for I don't know how many years, but back past '52.

Q. And this language on this page is what you are referring to? A. That is right.

Q. Under the heading "Partners' Source of Profit"? A. Yes.

Mr. Harmon: That is all.

The Court: Do you have any further questions?

Mr. Biggins: I certainly have.

Recross-Examination

By Mr. Biggins:

Q. You do have a background in accounting and finance, we may be sure? A. That is right.

Q. And we know there is a great distinction between "profit distribution" and "capital account," we do know that? A. That is true.

Q. Now, on Exhibit 30, which is before you, sir, the very first page of the general statement, which would be Page 2, [137] do you see the line "the partners"? A. Yes.

Q. "Max J. Kuney, age 58, and Max J. Kuney, Jr., age 34, are equal partners and general partners in all divisions."

May I skip down now to the heavy construction

(Testimony of Edward A. Coon.)

division, "Max Kuney, Jr., manages the heavy construction division in Spokane and Max J. Kuney with special partners Johnson and Greene manages the three other divisions in Seattle."

A. Yes.

Q. Did you know at that time that Mr. Claggett was a partner in the heavy construction division, as was testified by Mr. Henry? Did you know that?

A. I didn't in 1952.

Q. And you still don't know, do you?

A. Oh, yes.

Q. He is still a partner?

A. I know he is a partner now unless there has been a change.

Q. You were never sure when things were changed over there?

A. Yes, I think that we are.

Q. So I will ask you again, sir, is Mr. Claggett still a partner?

A. To the best of my knowledge he is, and he was indicated [138] to be a partner in the December 31, 1959, statement.

Q. A partner in the family partnership, you are clear what I am talking about?

A. Well, no.

Q. Partner in what?

A. A partner in the Max J. Kuney Company.

Q. The corporation?

A. The operation.

Q. Do I understand you to say that corporations have partners, a man so sophisticated in finance as you?

A. No.

(Testimony of Edward A. Coon.)

Q. What was he a partner in that you understood?

A. Well, he was a partner in the profit.

The Court: In the what?

The Witness: In the profits.

The Court: A partner in the profits?

The Witness: Yes, of the operation.

Q. (By Mr. Biggins): His name did not appear on this financial statement of which you are speaking, though, did it?

A. No, I didn't see it there.

Mr. Biggins: That is all.

The Court: That is all, Mr. Coon. You may leave whenever you wish.

(Witness excused.) [139]

HAROLD V. BOWEN

called as a witness on behalf of the Plaintiff, being first duly sworn, was examined, and testified as follows:

The Clerk: State your full name and spell your last name.

The Witness: Harold V. Bowen, B-o-w-e-n.

Direct Examination

By Mr. Toole:

Q. Where do you reside?

A. Spokane, Washington.

Q. What is your occupation?

A. I am a certified public accountant.

Q. What is a certified public accountant?

(Testimony of Harold V. Bowen.)

A. Well, he is an independent public accountant that is registered or certified by the state after passing an examination.

Q. Did you have to take an examination?

A. Yes.

Q. Where did you get your formal training and study?

A. Mostly through correspondence in accounting. I took economics in college.

Q. Is there any higher degree or designation of accountants than certified public accountant? [140]

A. No.

Q. Where have you worked since you have become a certified public accountant—when was that?

A. In 1946.

Q. Where were you working in 1946?

A. In Cheyenne, Wyoming.

Q. And in later years generally where?

A. Well, in Denver and Spokane.

Q. Did you have a number of contractors as clients?

A. Yes, at all times.

Q. When did you come to Spokane?

A. In 1952.

Q. With whom are you associated in Spokane?

A. Morris & Lee.

Q. What are Morris & Lee and Company?

A. Certified public accountants in Spokane.

Q. What was your position with them?

A. I was staff accountant, senior accountant.

Q. What does that mean?

A. Well, I was mostly in charge of work—in charge of most of the work that I did. In other

(Testimony of Harold V. Bowen.)

words, I wasn't working under the supervision of anyone but the partners of the firm.

Q. While working for Morris & Lee did you have occasion to perform services for Max J. Kuney Company? [141] A. Yes.

Q. About when was the first time you did some work for them?

A. I think probably it was about August or September of 1953.

Q. What occasioned your going and performing services for them?

A. Well, as I recall, at the inception it was because of the formation of the corporation. They asked me to assist in that. That is in the book—the accounting part of it.

Q. Were you an employee of Max J. Kuney Company? A. No.

Q. Just what was your relationship?

A. I had no relationship whatever with Max J. Kuney Company. The firm—the Max J. Kuney Company had employed the firm, and I was to do the work independently.

Q. Is the relation somewhat like a man who would hire a lawyer, the lawyer is not an employee of the man? A. Yes.

Q. From that time forward have you had occasion to examine the books of Max J. Kuney Company? A. Yes.

Q. How often do you examine the records of Max J. Kuney Company? [142]

A. Every year.

(Testimony of Harold V. Bowen.)

Q. How long were you acting in that capacity as a staff member of Morris & Lee?

A. Until 1958.

Q. What happened in 1958?

A. I left Morris & Lee and went into a partnership of my own.

Q. What is the name of that partnership?

A. Cole and Bowen.

Q. And that is a firm of certified public accountants?

A. Yes.

Q. Cole-Bowen and Company represent or do work for a number of contracting firms?

A. Yes.

Mr. Toole: Would the Bailiff please hand the witness Exhibit 32.

(Whereupon, a document was handed to the witness by the Bailiff.)

Q. Exhibit 32 is the financial statement of Max J. Kuney Company for the year ending December 31, 1954?

A. Yes.

Q. Would you read the certificate at the bottom of the page for the benefit of the jury?

A. "We have examined the accompanying consolidated balance sheet of Max J. Kuney Company, general partnerships; its [143] affiliated operating corporation, Max J. Kuney Company, Inc., and its partnership operating divisions as of December 31, 1954. Our examination include verification of the cash accounts, contract and commercial accounts receivable, notes receivable, and accounts and notes payable. We reviewed in detail all other balance

(Testimony of Harold V. Bowen.)

sheet accounts to the extent considered necessary in the circumstances.

In our opinion the accompanying consolidated balance sheet and related schedules and footnotes present fairly the financial position of Max J. Kuney Company at December 31, 1954, in conformity with generally accepted accounting principles applied on a basis consistent with the preceding year."

Q. Would you read the caption at the top of that certificate?

A. "Certificate of Independent Certified Public Accountant."

Q. What do you mean by "independent" in that statement?

A. Well, you are unbiased, uninfluenced by any other party, completely independent.

Q. Who signed that particular certificate?

A. Well, this certificate was prepared while I was with Morris & Lee and signed by L. Gordon Lee.

Q. Who did the work? A. I did the work.

Q. And you have examined the books every year since then? [144] A. That is right.

Q. What person in your opinion knows the most about the books of Max J. Kuney Company and related organizations? A. I do, unquestionably.

Q. Do you know more about the books than either Mr. Kuney, Sr., or Max, Jr.?

A. Yes.

Q. What do you mean by "consolidated statement" as stated in that certificate?

(Testimony of Harold V. Bowen.)

A. Well, the balance sheet is consolidated—consolidated balance sheet means that it is the—that all the entities involved, the Max J. Kuney Company Corporation, the partnership, and the operating partnerships that were in Seattle, all consolidated in one statement, and the entire company account would be eliminated in the statement.

Q. Is this a common concept in the public accounting field? A. Yes.

Q. For related organizations?

A. Yes, very common.

Q. Are you familiar, Mr. Bowen, with the total amount of income for the years 1952, '53, and '54, which the government—correction, total amount of income for those three years earned by the trusts which the government is seeking to tax in this lawsuit—I misspoke [145] myself. Strike the question.

Are you familiar, Mr. Bowen, for the years 1952, '53, and '54, with the amount of income earned by the trust which the government contends should be taxed to the adult Kuneys? A. Yes, I am.

Q. Approximately just what is the total amount of that income? A. \$111,000.

Q. Directing your attention, Mr. Bowen, to January 1, 1955, on that date how much money did the two Kuneys and the two trusts have invested in the partnership? A. Well, also the children.

Q. These figures on the blackboard are approximate—and also including the investments of the two children representing the distribution of income made in the year 1952?

(Testimony of Harold V. Bowen.)

A. Approximately \$1,325,000.

Q. That is this figure right up here (indicating)?

A. Yes.

Q. This is the total investment of the partnership?

A. Yes.

Q. Now, what was the portion of the capital of the money invested in fixed assets—not portion—how much of this total capital of \$1,325,000? [146]

A. Well, it would be \$305,000 plus \$250,000 or \$555,000.

Q. That is the sum of these two figures (indicating)?

A. Yes, it is.

Q. The sum of these two figures for a total of \$555,000?

A. Yes.

Q. You testified that it represented the investment in the fixed assets?

A. Yes.

Q. How much money did the adults have invested in fixed assets of this partnership?

A. \$305,000.

Q. And how much money did the trusts have invested in the fixed assets?

A. Approximately \$250,000.

Q. What do we mean by this caption, "Surplus Capital"?

A. That is capital invested in the partnership in excess of the amount invested in fixed assets.

Q. Who owned the surplus capital over the amount invested in the fixed assets?

A. Primarily the adult Kuneys; the children also.

Q. How much did they own?

A. \$740,000.

(Testimony of Harold V. Bowen.)

Q. Approximately? A. Approximately.

Q. And the children individually owned approximately what? [147] A. \$30,000.

Q. Now, you were here yesterday and heard the testimony of Max Kuney, Sr., with respect to the withdrawal of the capital stock from the partnership? A. Yes, I was.

Q. Who owned the capital stock—or rather whose money was invested in this capital stock in this partnership?

A. I don't know—at the inception the stock was owned by the partnership.

Q. But was it included in the surplus capital?

A. Oh, yes, with the children's money all invested in fixed assets, and obviously the corporate stock investment was included in the surplus capital of the adult Kuneys. It had to be.

Q. Now, when the corporate stock—Strike that. How were the rental income profits received by the partnership divided between the partners?

A. They have always been divided on the basis of capital investment.

Q. Capital investment in what?

A. Well, prior to the 1955 total capital investment in—and beginning in 1955 in the fixed assets.

Q. And referring to January 1, 1955, and to the figures on the blackboard, what percentages were used in the year 1955 for the division of rental income earned by the [148] partnership?

A. Well, 56 per cent of the total rental income

(Testimony of Harold V. Bowen.)

would have gone to the adult Kuneys, and 44 per cent would have gone to the trusts.

Q. Now, when the corporate stock was withdrawn from the partnership, did that affect the investment of the partners in the fixed assets?

A. No, it did not.

Q. What effect did the withdrawal of the capital stock have on the ratio in which rental income earnings were shared?

A. It didn't have any effect on the ratio of rental income. It reduced the capital equities of the adult Kuneys.

Q. From what?

A. From \$740,000 to \$340,000.

Q. Approximately? A. That is right.

Q. Did the withdrawal of the corporate stock reduce the investment of either the adults or the trusts in the fixed assets? A. No.

Q. Did the withdrawal of the corporate stock affect in any manner the share of profit from rental income earned by the trusts?

A. No, it did not. [149]

Q. Did the corporate stock pay any dividends?

A. No.

Q. Has it ever paid dividends?

A. No, it has not.

Q. Now, you were here in court yesterday and heard Mr. Kuney, Sr., testify? A. Yes.

Q. And you heard the reference to the "Bible"?

A. Yes.

Q. Have you reviewed each of the entries in

(Testimony of Harold V. Bowen.)

the Bible? A. Yes, I have.

Q. Every one of them? A. Yes.

Q. Do you understand every entry in the Bible?

A. Well, I did at one time. I can't remember all of them now. I reviewed them all carefully at the time I was doing the work, yes.

Q. And given an adequate opportunity can you refresh your recollection? A. Yes.

Q. Are there any adjusting entries in the Bible which are contrary to sound accounting practices?

A. Not that I know of. I am sure there wasn't, or I would have disclosed them at one time or another.

Q. Are there any entries in this Bible which are inimical [150] or unfair to the trusts?

A. No.

Q. Now, yesterday you saw Mr. Biggins write some percentages on the blackboard, and with respect to the division of profit for the year 1955, as I recall, Mr. Bowen, didn't he say that the Bible showed that Max Kuney, Sr., was to get 33.66 per cent of the profit—correction—that the trust for Johnnie was to get 33.66 per cent of the profits?

A. Yes, I believe that is correct.

Q. And Max, Sr., was to receive 16.99 per cent of the profits? A. Yes.

Q. You do recall that testimony?

A. I recall that.

Q. Do you recall that later on amended income tax returns were filed, as pointed out by Mr. Biggins, in which the percentages were changed? Do

(Testimony of Harold V. Bowen.)

you recall that? A. Yes.

Q. I don't recall the exact percentages. They were erased before I noted them down.

A. Well, they are approximately the ones that are on there now.

Q. Approximately these percentages (indicating)? A. Yes. [151]

Q. In total? A. Yes, that is in total.

Q. Who prepared that amended income tax return that had the different percentages on them?

A. I did.

Q. Are you familiar with the reasons for the change from percentages of division in the Bible to the percentage of division on that amended income tax return subsequently filed?

A. Yes, I am.

Q. Would you describe to the jury why that change was made or what occasioned it?

A. Well, the principal reason for the change was because in the Bible the total amount of fixed assets that was used in determining these percentages did not include some property that was in California and which had been sold about the time the Bible was prepared. But it was on hand at the beginning of 1955 and at the beginning of 1956, and since that was a part of the fixed assets, when I prepared the amended returns, it was necessary for me to go back and revise the figures in the Bible and include that California property in the fixed assets, which greatly changed the percentages. But since the agreement was to divide the profits on the basis

(Testimony of Harold V. Bowen.)

of fixed assets, we had to, of course, include all [152]
the fixed assets.

Q. Was the California property actually on the books at the beginning of 1955?

A. Oh, yes, it was on the books.

Q. Was there anything more involved than an arithmetical error in adding the fixed assets?

A. No, absolutely not. That is all it was.

Q. Did Mr. Kuney have anything to do with changing the ratios?

A. No. I doubt if he even knows it now.

Q. Who did compute these change ratios?

A. I did.

Mr. Toole: You may inquire.

The Court: Cross-examine, please.

Cross-Examination

By Mr. Biggins:

Q. May it please the Court, Mr. Bowen, so we may understand each other with some precision in accounting as we proceed here, may I inquire, sir, what standard reference books you consider authoritative for general accounting principles?

A. Well, there is a great many of them.

Q. The ones which you use in your practice, sir.

A. Finney is used quite a bit. [153]

Q. Finney, I believe, sir, is a college book and not a professional man's reference book. Do you mean the new edition by Finney with Miller or the old edition?

(Testimony of Harold V. Bowen.)

A. Well, of course, our generally accepted accounting principles.

Q. I am asking about Finney, sir. Are you talking about the new edition with Miller or an old edition?

A. Well, I don't really recall.

Q. You don't recall?

A. No.

Q. All right. Again, sir, what general reference books in accounting do you consider authoritative and use in your practice?

A. Montgomery on Auditing, The American Institute of Accountancy, and the CPA Handbook is used extensively.

Q. What handbook?

A. The American Institute of Accountancy, CPA Handbook.

Q. I think, sir, that the American Institute put out no handbook.

A. Oh, yes, they do.

Q. An accounting handbook is published by the Ronalds Press, second and third edition?

A. The American Institute also has a CPA handbook which defines——

Q. (Interposing): They are research bulletins, and Mr. Miller [154] put out the handbook?

A. No, absolutely not, there are two volumes. The CPA Handbook, I am sure that any CPA would know of.

Q. We are clear that Paton's Handbook is authoritative?

A. Yes.

Q. And Wixon's Joint Handbook of the same press is authoritative?

A. Yes.

(Testimony of Harold V. Bowen.)

Q. The American Institute Research Bulletins both on general accounting and auditing?

A. Right.

Q. Now, the American Institute's Certified Public Accountant's name has been changed?

A. Yes.

Q. And in auditing we accept Montgomery?

A. Yes, we use Montgomery almost entirely in auditing.

Q. He has now passed away, but his book is still in effect?

A. Yes.

Q. Now, we were speaking, I believe, in the beginning, Mr. Bowen, about the certificates you put on the 1953 and the 1954 financial statements. We were speaking of that?

A. Yes.

Q. Now, this is not what we call an unqualified CPA certificate, is it? [155]

A. Which ones are you talking about?

Q. Exhibits 32 and 33. Please examine your certificates.

(Whereupon, there was a brief pause.)

Q. My pending question, Mr. Bowen, is, this is not an unqualified CPA certificate, is it?

A. The 1953 particularly isn't, but——

Q. My question, Mr. Bowen, this is not an unqualified CPA certificate, is it?

The Court: Please answer precisely the question.

A. No.

Mr. Toole: Which one?

(Testimony of Harold V. Bowen.)

Mr. Biggins: 32 and 33.

Q. (By Mr. Biggins): I shall try to be precise in my questions. A. Okay.

Q. Now, you did certify, however, that these statements were prepared in accordance with generally accepted accounting principles applied on a basis consistent with the preceding years? You did say that? A. That is right.

Q. After the Bible came out—after some of these other changes came out, could you still put in your certificate, Mr. Bowen, that it had been applied in sound accounting principles consistent with the preceding year? [156] A. Yes.

Q. Go ahead.

A. You will notice that it is a consolidated statement. Those figures are all intercompany accounts which does not affect the total consolidated position at all. If the corporation pays rent to the partnership, in the consolidation it is eliminated.

Q. I am quite aware, Mr. Bowen, what you mean by a consolidated statement.

A. So actually you wouldn't change the financial position any if the corporation paid the partnership rent or interest or any of those intercompany accounts, and it would not affect the consolidated financial position at all.

Q. My question then is a simple one—before we get to that, this much is clear, Mr. Bowen, if we use the sound accounting principles with a clear partnership agreement understanding, there is no need to change the amount of income—strike that.

(Testimony of Harold V. Bowen.)

If we have a clear partnership agreement, and if we apply sound general accounting principles, it is possible for a competent CPA, such as you, to determine the amount of income shortly after the close of the fiscal year? That is possible, isn't it?

A. Generally speaking, it is. [157]

Q. Was that true in this case?

A. In some of the years it wasn't, I don't believe, as between the related entities.

Q. And the reason was not a lack of clarity or the definition of the accounting principles to be applied?

A. No.

Q. The ambiguity was the instructions to come from Mr. Kuney? Please don't fence with me, Mr. Bowen. That is true, isn't it?

A. I don't quite agree that it had to come from Mr. Kuney. I can't see where that has anything to do with it.

Q. It didn't come from you, sir, I submit?

A. I think that——

The Court: Answer the question each time.

A. I didn't.

The Court: The question is did, the ambiguity come from you?

The Witness: No.

The Court: All right.

Q. (By Mr. Biggins): Now, you say, I take it, sir, that you are more familiar with the books of account over there than anybody else?

A. I think so.

Q. And, of course, he asked about Mr. Kuney,

(Testimony of Harold V. Bowen.)

Jr., and Mr. Kuney, Sr. How about Mr. Peterson?

What is Mr. Peterson's [158] job?

A. He is the office manager.

Q. And what is his corporate title?

A. Secretary.

Q. And also anything else? Has he been considered since you have been dealing with the company as also, perhaps, treasurer?

A. I think so, yes. I am not absolutely sure.

Q. And although he has been treasurer of the company, you still know more about it than he does?

A. I think if it came to—I think if it was a matter of reviewing the books and analyzing the capital accounts and various things like that, I do, yes.

Q. Did you prepare any of the original vouchers on the adjusting entries? A. No, none.

Q. Did Mr. Peterson prepare some?

A. Yes, he prepared all of those.

Q. And do you know more about the adjusting entries that he prepared than he does? I take it that is your testimony now?

A. No, I didn't say I knew more about the details of the posting of the books. I said I knew more about——

Q. (Interposing): I didn't ask about the posting, I asked about the vouchers for the adjusting entries. [159] A. No.

Q. Is Mr. Peterson over here if I should have questions to ask him?

A. I don't believe he is, no.

(Testimony of Harold V. Bowen.)

Q. You are the one who came over?

A. Yes.

Q. I should like to inquire in detail about the Bible, but before I do, there is something here I would like to put to rest and come back to later, if I may.

Now, as a certified public accountant, Mr. Bowen, I believe you did testify that—and may I put a double line here—did you put this on the black-board, Mr. Bowen?

A. No, two of us together.

Q. I will put the double lines and the dollar signs here. A. Yes.

Q. \$1,325,000 represents what?

A. The total investment in the business.

Q. All right. Total investment.

What was your understanding was the agreement—what were you told was the understanding as to the manner in which profits were to be distributed to Mr. Kuney and the trust? What were you told?

A. That they were to be distributed on the basis of investment. [160]

Q. All right. Now, Mr. Kuney, Sr., and Mr. Kuney, Jr., have how much here?

A. \$740,000.

Q. May I add that here. One million forty-five, is that correct? A. Yes.

Q. That is their total investment?

A. Yes.

Q. Now, the children have how much?

(Testimony of Harold V. Bowen.)

A. \$250,000.

Q. And may I add this?

A. Plus thirty thousand.

Q. Two hundred eighty thousand dollars. That is their total investment?

A. Yes.

Q. Now, we have established that the earnings were going to be distributed in accordance with the total investment, didn't we? We established that just three questions ago, didn't we?

A. Yes.

Q. Now, it is clear to you that the amount in the surplus capital account of the adults is determined by they, themselves? That is clear, isn't it? Are you familiar with the chart of accounts?

A. Yes. [161]

Q. And this is marked on the books as "personal account," isn't it?

A. Yes.

Q. And it is treated as a personal account by Mr. Kuney and his son, Junior?

A. Yes.

Q. All right. But this personal account from an accountant's point of view is considered here as part of the invested capital?

A. Yes.

Q. But when we compute a profit to be distributed in 1955, as you indicated here, we did not include this amount in the rent to be charged, did we?

A. No.

Q. This '56 per cent is only on the basis of \$305,000?

A. That is right.

Q. And if we added this seven hundred and forty over here to get the million, it would be much, much greater, wouldn't it?

A. Yes, it would.

Q. And as far as you know as an accountant,

(Testimony of Harold V. Bowen.)

sir, they can change the amount of their personal account at any time? A. That is right.

Q. Now, then, we are talking about the surplus capital of the children, this thirty thousand? Are you with me, sir? [162] A. Yes.

Q. You know what that represents?

A. Yes.

Q. And it represents the distributions made by the trustee? A. That is right.

Q. And the distributions made by the trustee are Max, Sr., and Max, Jr.? A. Yes.

Q. And so they have completely in their control the ability at any time to determine what this amount may be (indicating)?

The Court: When you say "this," what do you mean?

Q. (By Mr. Biggins): The so-called surplus accounts. A. I don't see——

Q. I will start out easier.

A. I don't understand the control part of it.

Q. We did start out with a trust corpus, did we?

A. Yes.

Q. To which the earnings came in, as we talked about the computations? A. That is right.

Q. You have examined the trust instruments?

A. Yes.

Q. Now, money or distribution from the trust itself can be [163] made to the personal account of the children at any time in accordance with the trust instrument, you do understand that?

A. Yes.

(Testimony of Harold V. Bowen.)

Q. And having read the trust instruments, you also understand that Mr. Kuney can take it out of a trust at any time and put it over here (indicating), do you understand that? A. Yes.

Q. And Max Kuney can take it out of the trust any time and put it over here (indicating)?

A. Yes.

Q. And by that discretion, they do directly control in a way what this percentage (indicating) will be, don't they? A. They do.

The Court: Well, that is the point, that is the question, they could if they chose to exercise it?

The Witness: They could, yes.

Q. (By Mr. Biggins): We are also clear this was their personal account (indicating)?

A. Yes.

The Court: Please, when you say "this"—

Q. (By Mr. Biggins): This surplus capital account, being [164] the \$740,000? A. Yes.

Q. Which they completely control as far as you know as an accountant? A. Yes.

Q. By controlling that, that fixes this percentage (indicating) at any time, that percentage can be determined any time depending on what they do on their personal account, that is true, as an accountant?

A. Not since the beginning of 1955.

Q. I didn't say what they did at this point. I said what they can do? A. Yes, that is right.

The Court: The question is what they have the power to do, not what they did. Do you understand that?

(Testimony of Harold V. Bowen.)

The Witness: Yes.

The Court: Now answer the question.

The Witness: I answered it yes.

Q. (By Mr. Biggins): All right. Now I will speak and address my attention for a moment, sir, about what they did do. We are clear on what they did do? You did take down my percentages? Did you have a chance to check, them, I take it?

A. Yes. [165]

Q. You found no inaccuracy in what I put on the blackboard? A. No.

The Court: Do you mean on the blackboard yesterday?

Mr. Biggins: Yes, yesterday.

Q. (By Mr. Biggins): And so, I take it—please, sir, my questions, will you understand they are one accountant to another. I am talking in accounting language. Your language I know, sir, and I certainly hope you know mine.

And before I do, let us put this very small point at rest, you did not prepare—you did take care of the accounting of this firm for a number of years by audit? A. Yes.

Q. Your firm did not prepare the 1953 income—original 1953 income tax returns? A. No.

Q. Or the 1952 income tax returns?

A. No.

Q. Or the 1954 income tax returns?

A. No.

Q. And you didn't even prepare the original 1955 income tax returns?

(Testimony of Harold V. Bowen.)

A. No, that is right. [166]

Q. Or the original 1956 returns? A. No.

Q. Who did prepare those?

A. Those were prepared by the company.

Q. I see.

A. But in all cases they were reviewed by me and checked, except for 1952 and '53, when I wasn't doing the work.

Q. And, of course, it is the usual professional practice when an independent CPA reviews and verifies the tax returns, to put their stamp certificate on it? A. I don't think if you review it.

Q. There are three certificates that an accountant can put on a tax return? You are aware of that?

A. Yes.

Q. Which one did you put on these tax returns?

A. What do you mean, three certificates on a tax return? We don't put any certificates——

Q. There is a certificate at the very lowest level prepared on the basis of information furnished?

A. Yes, but those don't have to be put on tax returns. I think most accountants don't put them on there. At least, it isn't the practice in our area to put any statement on a tax return.

Q. If you make a full audit of the corporation, including the preparation of the return, may I ask, Mr. Bowen, do [167] you put the imprimatur of your firm on it?

A. Yes, we just put the name of the firm. If we prepare the return, we sign it and put our stamp on it, but that doesn't any qualifications at all.

(Testimony of Harold V. Bowen.)

Q. Addressing your attention, if I may, then, to 1955, you are aware that in the original returns as filed—the original tax returns——

A. Yes.

Q. I am taking Max Kuney, Sr., only, may we also understand that? A. Yes.

Q. That on the original return his share of the understanding was that Max, Jr., and Max, Sr., split the profits, isn't that right, fifty-fifty each?

A. Yes, that is right.

Q. Now, no matter what the capital account of Senior and Junior, they always split their half even? That is what you understood?

A. That is right.

Q. And after they got their half, then this other agreement came into operation how they would split it with their trust? A. Yes.

Q. You so understood that? A. Yes. [168]

Q. And so what Max, Sr., got personally added to what his trust for John R. got would always total fifty per cent, wouldn't it? A. Yes.

Q. And in the original 1955 return, he got 41.6 per cent of the income and his trust for John R. was 8.84 per cent? A. Yes.

Q. All right. Now, in the Bible, and you said you were familiar with the entries in the Bible and the figures I put on the blackboard yesterday?

A. Yes.

Q. All right. This is Senior, this is John R. (indicating). Now, in the Bible—on this Bible, may we be clear on this, too, the Bible is not a book of

(Testimony of Harold V. Bowen.)

Genesis defining things from the beginning, the inception of this partnership at all?

A. No, it is not, that is right.

Q. Now, in the Bible, Senior goes down to 16.99?

A. Yes.

Q. And the son's, John R.'s, goes up from 8.84 up to 33?

A. Yes.

Q. 33.66?

A. Yes.

Q. In the beginning Senior had almost five times as much income as John R.? [169]

A. That is right.

Q. But the time we come to what the Bible says, we got about twice as much for John R. as we have the father?

A. Yes.

Q. And then we have your amended returns for 1955, and I believe on your amended return, if we computed it right, it is 28.01, which is my figure, Mr. Bowen?

A. That is correct.

Q. Which would be approximately right?

A. Yes.

Q. And I have for John R. 22.42, which, if we divide it, he has approximately half of this?

A. Yes.

Q. So that is right, isn't it?

A. Yes, that is right.

Q. So now we have—going back again, the father has five times as much as John R., he has got half as much, and now he has got about fifty per cent more. That is what the history of this transaction on these shows?

A. Yes, that is right.

Q. Now, please listen to this question carefully, I do request some precision of answer, if the invest-

(Testimony of Harold V. Bowen.)

ment—if this investment—is a true and correct figure (indicating)?

The Court: You must use the figure [170] because the record will not reflect what “this” is. We all see what it is, but the record does not.

Mr. Biggins: I always caution the witness, and yet I make the same mistake myself.

Q. (By Mr. Biggins): You have no doubt this figure is right (indicating)? It is an approximate figure within a few thousand dollars.

The Court: The figure referred to is \$1,325,000.

All right.

Q. (By Mr. Biggins): Now, assuming that is right, we must then also assume here that the children had a 44 per cent interest, as you had put up here (indicating)?

A. That 44 per cent is only of the fixed assets. The 44 per cent represents the percentage of their investment in the total amount of fixed assets only, not in total.

Q. Let me ask the question, assuming this (indicating) remains constant——

The Court: Please use the figure.

Q. (By Mr. Biggins): ——\$305,000, then these percentages (indicating) should remain the same?

A. Yes.

Q. Now, if the parents in fact have a 56 per cent interest in \$305,000, and the children have a 44 per cent in the \$250,000—are you with me [171] so far? A. Yes.

Q. Let us assume we made a mistake there and found there was a \$305,000 property down in San

(Testimony of Harold V. Bowen.)

Francisco which we all forgot about, an identical amount—are you with me? A. Yes.

Q. We add that back in—— A. Yes.

Q. And when we add this back in, the adults still have 56 per cent interest, don't they?

A. No.

Q. They don't?

A. No, their percentage then would change.

Q. Why?

A. If the total there now is \$555,000 for the two, but if there was another three hundred thousand added to the total fixed assets, then it would increase the total and change the percentages.

Q. All right. Now, on that point, you were here yesterday and heard Mr. Max, Sr., testify that they were trading in some of these equipment and fixed asset accounts? Did you hear that testimony?

A. Yes.

Q. All right. And by whatever he did in the purchase or sale of those fixed assets, it was controlled by the [172] amount of this figure (indicating)—it affected it, didn't it?

A. Yes, it would affect it, yes.

Q. And depending on what he did there would affect what the percentages are here (indicating)?

A. Yes, it would.

Q. And who did control the sale and exchange of fixed assets?

A. I think that is dictated by business circumstances.

The Court: What individual decided what the circumstances were?

(Testimony of Harold V. Bowen.)

The Witness: I suspect that both partners, Max Kuney, Jr., and Max Kuney, Sr.

Q. (By Mr. Biggins): Now, in looking at these 1955 figures, if I may, Mr. Bowen, I notice that Senior's assets in percentage here of 41 goes down to 16.99? A. Yes.

Q. I take it what happened here is the sudden loss of some assets, and that is why the percentage change? A. No, that isn't it at all.

Q. But when we go from 16.99 up to 28, we suddenly found some other assets?

A. Just one, the property in California.

Mr. Biggins: If the Court please, before my next battery of questions, which will be the [173] so-called "Bible," I would like to organize and have the witness refresh his recollection.

The Court: Yes, all right, we will take the morning recess at this time.

(Whereupon, a short recess was taken.)

The Court: Proceed, please.

Q. (By Mr. Biggins): May it please the Court, I believe you have on the stand available and before you, Mr. Bowen, Exhibit G, which we do refer to as the "Bible," don't we? A. Yes.

Q. Now my first three questions generally, and if you would care to examine page 2 where I have put the bookmark—do you see the letter of March 1, 1957? A. Yes.

Q. You do see the signatures at the end of that letter? A. Yes.

(Testimony of Harold V. Bowen.)

Q. And that the signatures were notarized on page 5? A. Yes.

Q. And if you care to examine this letter, sir, before you answer my questions, it is true, and Mr. Kuney told you, that the Kuney family partnership was formed by the two adult Kuneys to reduce their income taxes while living and to save inheritance taxes at their death, that is true, [174] isn't it? A. That is what it says.

Q. And they told you, sir? You were so advised?

A. No, they didn't tell me because I wasn't even there when they formed the trust.

Q. You use the Bible, don't you? A. Yes.

Q. And you were advised, at least in writing that the Kuney family partnership was formed by the two adult Kuneys to reduce their income taxes while living and to save inheritance taxes at their death?

A. I repeat, that is what it says in here.

Q. And you were given this to use?

A. Yes.

Q. All right. And it is also true that they told you that so long as Mr. Kuney, Sr., was living and Mr. Kuney, Jr., was living, both intended to continue to act as trustees during their lifetime? A. Yes.

Q. All right. Now, our next question is about the formation of this corporation and who owned it, Mr. Bowen, so we can lay that at rest, and before I ask the question, I invite to your attention the language on Page 2 at the bottom,

“The Kuney Family Partnership capital was invested entirely in fixed assets consisting of [175] equipment, machinery, land, and buildings held out

(Testimony of Harold V. Bowen.)

of the corporation in 1953 for the main reason: The corporation, with W. R. Wiginton and W. B. Peterson holding their agreed 20 per cent interest, would live on and be a reliable caretaker and user of such fixed assets after the adult Kuney's would die and would provide a steady and carefree income to their widows and the trusts for their children by paying them for the use of such fixed assets."

Now, I invite your attention also to the next bookmark which I have placed in there, Mr. Bowen, which is, may we call it, a journal entry on journal voucher two, sir. Do you see it there, or could I help with it, June first, 1953? Journal voucher two?

These are accounting journal entries, are they not? A. Yes.

Q. And above the one I invited your attention to, we see typing across "MJK" and below we see the same typing, "MJK." What does that mean?

A. That indicates the journal voucher was prepared by Max J. Kuney.

Q. Senior or Junior?

A. Presumably, Senior. [176]

Q. Now, this journal voucher entry to an accountant on the basis of this journal entry, what does the debit to capital, Max J. Kuney, two hundred thousand dollars, debit to Max J. Kuney, Jr., two hundred thousand dollars, and credit to the account of 2801, capital stock, dated June 1, 1953, mean to you, Mr. Bowen, as an accountant?

A. It means that Account 2861 capital for Max J. Kuney, Jr., was charged with two hundred thou-

(Testimony of Harold V. Bowen.)

sand dollars and the account 2801 was credited, which would be the corporation capital stock account, two hundred thousand dollars.

Q. And if you assumed with me for the moment, Mr. Bowen, that \$400,000 represents all of the capital stock of the corporation at that time, as an accountant from this journal entry, who were the owners of such capital stock?

A. Max Kuney and Max Kuney, Jr.

Q. How about the children, the trusts?

A. This doesn't indicate the children as owning any.

Q. And the date, again, is what?

A. This is dated June 1, 1953.

Q. All right. Now, let's look at the next date, December 31, 1956. Now we see a debit to Mr. Wiginton for \$80,000; to Mr. Petersen for \$20,000, and corresponding credits in the capital stock account.

A. Yes, that is correct. [177]

Q. Now, as an accountant, from this journal entry when was the first time that Mr. Wiginton or Petersen became shareholders in this corporation?

A. December 31, 1956.

Q. All right. While I am finding the next page that I wish to inquire about, Mr. Bowen, it is true that the first year—at the end of 1952, I am speaking now of 1952, that the profits distributed were determined on the basis of the net total investment account, the first year, that is true, isn't it?

A. Yes.

Q. And could you turn with me to journal

(Testimony of Harold V. Bowen.)

voucher No. 1 of the Bible, we do see corporation minutes of February 7, 1957—are you with me, Mr. Bowen? A. Yes.

Q. And what do we mean by “journal voucher”?

A. This is a recording entry prepared in journal form to record information in the books.

Q. And these instructions at the top of this, which is before you, I take it, sir, is a management directive to the accountant as to what to do?

A. That is correct.

Q. Now, included in that management directive of what to do you see the language appearing after the parentheses and the numeral three, “Kuney partnership,” do you see [178] that? A. Yes.

Q. And what does it say about the Kuney partnership?

A. You have the original before you. I only have these eight photostatic copies.

(Whereupon, a document was handed to the witness.)

A. (Continuing): “Kuney partnership shall not charge the corporation rental for the use of its fixed assets fiscal year ended 1955 and 1956, but corporation shall pay interest on the partners’ investment in fixed assets at the interest rate corporation pays to banks for borrowed money during those years.”

Q. That was a management directive to the accountant, which was carried out, as far as you know? A. Yes.

(Testimony of Harold V. Bowen.)

Q. Now, the income to be distributed to the parents and the income to be distributed to the children will vary depending upon whether we take a percentage of this or whether we take a percentage of that (indicating)? A. Yes.

Q. And in some years we charge investments at interest rates here (indicating)? A. Yes.

Q. We will have that entirely different income than if we [179] computed as you did here for '55?

A. Yes.

Q. Now, here in 1955 you said rent was charged by this computation, didn't you? Didn't you so testify? A. Yes.

Q. And we are clear on the year 1955?

A. Yes.

Q. But the first management directive to the accountant was what again, "Kuney partnership shall not charge the corporation rental for the use of its fixed assets fiscal year—" what?

A. 1955 and 1956.

Q. But do what?

A. "—but the corporation shall pay interest on the partners' investment in fixed assets—".

Q. That isn't what you did here? That is clear, you didn't do that here, yes or no?

A. Well, on the original returns it was done.

Q. Do you understand the question? You didn't do that here?

The Court: He is asking you if you did that on the blackboard recitation which you prepared here this morning. That is what he is asking.

(Testimony of Harold V. Bowen.)

A. No.

Q. (By Mr. Biggins): Incidentally, in 1959, with which you are very familiar, they didn't charge any rent at all [180] in '59 either, did they?

A. No.

Q. Now look at journal voucher No. 3, which, I believe, sir, is over just one page——

A. Yes, I have it.

Q. Now, I am glancing down where it says, "To record following capital accounts, Kuney partnership." Do you see that? A. Yes.

Q. And we see "MJK" above it and "MJK" below it, which means what?

A. Max J. Kuney.

Q. Now, a generalized and professional question, Mr. Bowen, in applying generally accepted accounting principles to the books and records of a partnership, is it good and sound accounting principle to set up a capital surplus account in a partnership?

A. It is an unorthodox method. However, in this case I see nothing wrong with it.

Q. Do you find such an account ever suggested in the book you referred to by Finney?

A. No.

Q. Do you find such an accounting suggested in Mr. Paton's Handbook? A. No. [181]

Q. Do you find such an accounting principle suggested in the two volumes of the American Institute of Accounting? A. No.

Q. Do you find such accounting suggested in Wixon's New Edition? A. No.

(Testimony of Harold V. Bowen.)

Q. Do you find such an accounting suggested in Montgomery? A. No.

Q. Have we suggested the books we talked about a few moments ago? A. Yes.

Q. All right. But capital surplus accounts were established in this partnership by the directive of MJK, weren't they? A. Yes.

Q. And that was this personal account—this personal surplus account you were talking about on the blackboard of \$740,000? A. Yes.

Q. Which was under their control, we have established that? A. Yes.

Q. And under their control, they could determine the amount of income distributed to them, we established that? A. Yes. [182]

Q. Now, it is equally true, unless you want to go all the way through this, Mr. Bowen, it is equally true that sometimes in some of these years they computed the interest on this (indicating)——

The Court: On what?

Q. (Continuing): ——total investment, and in other years they computed it on breakdown, including your so-called fixed assets? They went back and forth, that is true, isn't it? Must I go through these, or don't you know?

A. Generally speaking, I think that is correct.

Q. We save much time by that, Mr. Bowen.

Turning to journal voucher 4, please, sir, are you with me there, the partnership agreement, "The partners of Kuney family partnership agree——"?

A. Yes.

(Testimony of Harold V. Bowen.)

Q. "The partners of Kuney Family partnership agree that effective January 1, 1955, and until this agreement is changed in—" what?

A. "Writing."

Q. All right. Now, did you ever secure anything in writing after this that you know of?

A. No.

Q. All right. Then they will agree that until it is changed in writing, which you haven't received, "(1) Active partners Max J. Kuney and Max Kuney, Jr., shall receive [183] total compensation \$10,000 per year from partnership income to be divided equally between them and that the remaining income shall be distributed in proportion to each partner's—" what?

A. "Capital investment."

Q. In what? A. Partnership.

Q. And the remaining income shall be distributed in proportion to each partner's capital investment in the partnership, and we did agree, when we started out, this is the investment in the partnership? A. Yes.

Q. All right. But that isn't what you did here in distributing income as directed by Max J. Kuney, that is correct, too, isn't it? That is correct, isn't it?

A. Yes.

Q. Now, No. 2. "Active partner's compensation each year shall be taken entirely from partnership capital gains—" do you see that? A. Yes.

Q. "——if such are sufficient——"?

A. Yes.

(Testimony of Harold V. Bowen.)

Q. And pursuant to that, in looking on down, still with the initials what?

A. "M.J.K." [184]

Q. We see the account "Capital Gains" and "Capital Gains" what—"Capital Gains" what—"Compensation," "Capital Gains Compensation." Do you see that?

A. Yes, down below.

Q. Now, I ask you, sir, have you ever seen such an account as "Capital Gains Compensation" in Montgomery, Paton, Wixon, Kohler, Montgomery, or American Institute?

A. No.

Q. Have you ever seen or instituted the account "Capital Gains Compensation" in the books of account of any other plant which you have as a client?

A. No.

Q. Turning, if we may, sir, to this letter of December 20, 1954—do you see it there, signed by Max J. Kuney?

A. Yes.

Q. My copy of this, if I may read it accurately, Mr. Bowen, dated December 20, 1954, from Max J. Kuney, Seattle, to Max J. Kuney, Spokane.

"To Max: As agreed by telephone today, I am giving \$3,000 to John's——"

Then "trust" is marked out?

A. Yes, it is.

Q. "——and \$3,000 to each of your two children's—" and "trust" is marked out?

A. Yes. [185]

Q. "——and you and your wife together are giving \$6,000 to John—" and "trust" is marked out—"and \$6,000 to each of your children in 1955 and

(Testimony of Harold V. Bowen.)

each year thereafter until one or the other of us cancels this agreement.”

“Therefore, on January 1, 1955, please cause the gifts of \$9,000 to be credited to—” and “the trust for” marked out—“John and the gifts of \$9,000 each to be credited to the trusts—” We apparently missed that one. Do you see that—“the trusts”—“Max J. III—” and again “the trust for” is marked out—“Caroline, with charge of \$9,000 to be made to my capital account and charge of \$18,000 to be made to your capital account January 1, 1955, and each year thereafter until one or the other of us cancels this agreement.”

It is signed by Max J. Kuney, whose signature you recognize? A. Yes.

Q. Immediately below that it says, “We do not agree as to gifts for 1955 but we have agreed as to gifts for 1956.” Do you see that? A. Yes.

Q. Signed by Junior and Senior? A. Yes.

Q. And we have the journal entry doing that on the next [186] page, as we turn over on voucher five. Do you see that, “Debit to capital and credit to the children’s capital account”?

A. I don’t have it on the next page, but I am sure it is in here.

Q. If I may approach the witness——

The Court: Surely.

A. I know those entries are made.

Q. Now, another way in which the amount of income would be determined under this theory, another way would be for the trustee to make a gift

(Testimony of Harold V. Bowen.)

out of this account into this account (indicating)?
That would change the precentage, wouldn't it?

A. Yes.

Q. And a different percentage would result if you made a gift out of this account (indicating) into this account (indicating)? A. Yes.

Q. And the \$3,000 here (indicating) is geared to the maximum gift that can be made tax free each year, isn't it? A. Yes.

Q. And as you read this——

A. (Interposing): Apparently this is correct.

Q. But the gifts were not going to be made by Senior unless [187] Junior over here (indicating) agreed that he would make similar gifts under this letter, that is clear too, isn't it?

A. Yes, that is the way it appears.

The Court: What did you say? I did not hear your answer.

The Witness: Yes, that would appear to be clear.

Q. (By Mr. Biggins): One final question.

We will skip most of the details, 1955, we didn't apply this method of profit determination in 1959, either, did we? A. No.

Q. And you did not receive, as indicated here, you did not receive a subsequent written directive changing the prior way of doing it? A. No.

Mr. Biggins: That is all.

The Court: Is there anything further from this gentleman?

Mr. Toole: Yes, your Honor.

(Testimony of Harold V. Bowen.)

Redirect Examination

By Mr. Toole:

Q. The first thing I would like to clear up, Mr. Bowen, on [188] the blackboard, in Mr. Biggins' examination he indicated for the year 1955 there were three different profit-sharing ratios used, and he indicated these (indicating), the original return, the Bible, and the amended return? A. Yes.

Q. Is that correct? A. Yes.

Q. What is the reason for the variation between the Bible and the amended return?

A. That variation was due to the California property having been left out of the computation made in the Bible.

Q. An arithmetical error?

A. I think it was an inadvertence.

Q. Was the California property on the books of the corporation? A. Yes.

Q. Was it subsequently?

A. It was on the books of the partnership.

Q. On the books of the partnership, was it subsequently found?

A. No, it wasn't found, it was there all the time. It was just simply omitted in the original entry made in the Bible.

Q. So isn't it true that on your audit you simply corrected an error, and that is the only reason for that change? [189] A. That is correct.

Q. Now, on journal voucher one in the so-called

(Testimony of Harold V. Bowen.)

Bible, on Page 2 of journal voucher one, the last sentence of the first paragraph, commencing with subparagraph 3—have you found that?

A. Yes.

Q. Page 2 of journal voucher one, directing your attention to the subparagraph 3, which Mr. Biggins read to the effect that the Kuney partnership shall not charge the corporation rental for the use of its fixed assets during 1955 and 1956, are you aware of the circumstances prevailing on January 7, 1957, which presented that directive to you as an accountant?

Mr. Biggins: I must object here, your Honor, it has been established that he was the author of this Bible. The question was geared from his understanding from the Bible. This question goes back to the conclusions of the man that prepared the Bible.

The Court: Read the question.

(Whereupon, the last question was read by the reporter.)

Mr. Biggins: If I may, your Honor, as you see, what facts and circumstances led to that directive would require the testimony of Mr. Kuney, [190] himself, and by anybody else it would be a conclusion.

The Court: Do you have first-hand knowledge of this, or is this something somebody told you about? First, do you have any knowledge about facts and circumstances?

The Witness: Yes.

(Testimony of Harold V. Bowen.)

The Court: Who did you get it from?

The Witness: From my own working with the company.

The Court: All right. You may answer.

Q. (By Mr. Toole): Why was the decision made not to charge rent for 1955 and 1956?

A. The principal reason was because they were unable to determine how much—what rent they could charge and would be accepted by the Internal Revenue Service.

Q. Was agreement finally reached between the Internal Revenue Service and——

A. (Interposing): For the years 1952, '53, and '54 it was.

Q. When was that agreement reached?

A. Well, I couldn't remember that, it was sometime—I believe it was probably some time in '57, but I couldn't be sure of that date.

Q. Are you aware of the fact on the books of the company the rent was actually recorded for '55 and '56—for the years 1955 and 1956 at a later time?

A. Yes. [191]

Q. Following the settlement of the years '52, '53, and '54? A. It was some time after that.

Q. And isn't it true, then that the amended income tax returns for the partnership do record rental income? A. Yes.

Q. And that the division of the profits—of rental profits based upon the proportion of the investment of the fixed assets includes rental income actually credited to the partnership?

(Testimony of Harold V. Bowen.)

A. Yes, that is correct.

Q. For the years '55, and '56? A. Yes.

Q. Has the rent for the years 1955 and 1956 yet been settled with the Internal Revenue Service?

A. No, I believe not.

Q. Has any audit been received for those years yet? A. Not that I know of.

Q. Are they still being examined by the Revenue Agents?

A. I think they are in the process of audit at the present time.

Q. For the year 1955 you still have no report?

A. No.

Q. Who is making that audit?

A. I believe Revenue Agent Carney.

Q. Sitting at the other table? [192]

A. Yes.

Q. With respect to the surplus capital and the concept that part of the partnership investment is invested in fixed assets and part in surplus capital, you testified, I believe, under cross-examination that this was not an orthodox concept? A. Yes.

Q. Is there anything illegal about such a concept, to your knowledge?

A. Not that I know of.

Q. Does this concept go to anything more than the manner in which profits are divided?

A. That is all. It is used primarily for—as a basis for determining the profits, division of profits among the partners.

Q. As an independent certified public accountant

(Testimony of Harold V. Bowen.)

are you in a position to dictate how profits should be divided? A. No.

Q. Do you or do you not accept their direction—the directions of the partners?

A. Generally speaking, yes.

Q. And who are the partners from whom you receive the instructions?

A. Max J. Kuney, Sr., and Max J. Kuney, Jr.

Q. As individuals? [193]

A. As individuals and as trustees.

Q. Directing your attention to journal voucher four—do you have that? A. Yes.

Q. I believe Mr. Biggins read the first part of that paragraph, which said “—that the remaining income shall be distributed in proportion to each partner’s capital investment in the partnership.”

Do you see what I am reading? A. Yes.

Q. Now, directing your attention to the journal entry immediately below that statement——

A. Yes.

Q. Is the journal entry recorded by Max J. Kuney, does it divide the profits on the basis of the total investment in the partnership, in this case the \$1,325,000 figure, or has this divided the profits on the basis of investment in fixed assets?

A. It divides the profits on the basis of investment in fixed assets only.

Q. So notwithstanding the general statement preceding the journal entry that profits were to be divided on the basis of a total investment, doesn’t

(Testimony of Harold V. Bowen.)

that journal entry actually indicate that profits were divided on the basis of the fixed assets? [194]

A. Yes, it does.

Mr. Toole: No further questions.

Recross-Examination

By Mr. Biggins:

Q. May we clarify the last point before we get to the prior ones.

Look carefully at that journal entry again, please, sir.

A. Which one?

Q. The one you were just talking about on journal voucher four. Look at it most carefully with me for a moment.

It is clear, as you testified, that the entry made in the books does not conform with the managerial directive made, and Mr. Toole established that, didn't he, that that journal entry does not conform to the management directive?

A. The management directive says, "Total investment to each partner's capital investment."

Q. Please, can't you answer that?

The Court: Answer the question, please.

Q. (By Mr. Biggins): The journal entry doesn't conform? A. No.

Q. Let us examine the journal entry. This was the distribution of the earnings, isn't it, this journal entry? [195] A. Yes.

Q. The parents made some money, and the kids made some money, didn't they, from this journal

(Testimony of Harold V. Bowen.)

entry? A. That is right.

Q. Now we are most mindful of the distinction between this account, the fixed asset account and the surplus account, aren't we? A. Yes.

Q. And in this journal entry we have the debit to Max J. Kuney capital and capital gains, do you see that debit and credit there and ledger entry for about \$6,000? A. Yes.

Q. Now look with me at the account No. 2861—do you see that? A. Yes.

Q. Now, does 2861 mean the personal account or the fixed asset account?

A. I don't know, I don't have the chart of accounts.

Q. It is the personal account, isn't it?

The Court: These account numbers are a system designating various accounts on the books and records of the concern, is that right?

The Witness: Yes.

The Court: Ladies and gentlemen of the jury, when you refer to "2861," that is an arbitrary [196] number given to a particular account, for those of you who may not be familiar with bookkeeping and accounting procedures.

Q. (By Mr. Biggins): My pending question was, Account No. 2861, Max Kuney, is that the plant investment account, as you call it, or the personal account? A. It is a personal account.

Q. And the same question for Max, Jr., did that go to a personal account or to the plant asset account. A. To the personal account.

(Testimony of Harold V. Bowen.)

Q. Now, let us see what we did with the children. The trust for John R. Kuney, Jr., Account 2833, is that a plant asset account or the personal account?

A. That is the plant asset account.

Q. And it is the plant asset account that determines how much profits are to be distributed?

A. Yes.

Q. Mr. Bowen, as far as you know, who determined whether Max Kuney would have this money go into his plant account or into his personal account? Who determined that?

A. (No response.)

Q. Please, he didn't? It is easy, he didn't, did he?

A. Yes.

The Court: Is there any doubt in your [197] mind?

The Witness: Yes, I can't say that he did it. I have no knowledge—no personal knowledge that he personally did it.

Q. (By Mr. Biggins): A moment ago you were talking about your personal knowledge. Which is it? Do you have or don't you have?

A. I couldn't remember—all I am going on is what it says in this directive.

Q. All right.

A. Not what he told me. He didn't tell me anything.

Q. He what, sir?

A. Well, he didn't tell me anything about this. He has got his initials on it, yes, that is true.

Q. I will accept that, Mr. Bowen. But this much

(Testimony of Harold V. Bowen.)

is clear, the amount of income being distributed to the children depends upon the fixed assets computations which you talked about when you first testified this morning? A. Yes.

Q. Now, one more thing that could change the amount of income they got, we now find, is whether Max Kuney, Sr., directs that the earnings go to his fixed asset account or to his personal account? That is also true, isn't it? A. Yes.

Q. Depending on what he tells the accountant to do, it will determine this too, isn't that [198] true? A. Yes.

Q. And it is also true that some years he would do it one way and some years he would do it the other way, or must we look for that, too?

A. No, I don't think that is true. I think that it has been consistent following the finalization in 1957. For the year 1955, as it now stands in the books, it has been consistent from 1955 to the present time.

Q. Your language, I believe, sir, was unless it was finally what?

The Court: "Finalized" was the word you used?

The Witness: It was until it was finalized.

Q. (By Mr. Biggins): What do you mean by it in that paragraph, it was finalized?

A. The concept that rental income will be paid on the basis of investment in fixed assets only.

Q. And that was not finalized until 1950 what? Was that 1957?

A. I am sure that is right, until 1957.

(Testimony of Harold V. Bowen.)

Q. When you say it wasn't finalized, let us identify the personality, finalized by Mr. Kuney, Sr., or Mr. Kuney, Jr.? A. That is right.

Q. And the years we are talking about for income tax purposes are what? [199]

A. 1952, '53, and '54.

Q. Before even the method of income distribution was finalized, is that correct?

A. In those three years it was——

The Court: Can't you answer that question? It is obvious that if it wasn't finalized in 1957, it wasn't finalized during the period '52 and '53?

The Witness: No.

The Court: Why do you have any difficulty in answering that kind of a question?

The Witness: Because there actually was a change in determining the income as of 1955.

Q. (By Mr. Biggins): My preceding question before that battery, I believe, Mr. Bowen, is that they handled it one way at one time and one way at another, to which question you can say yes?

A. Yes.

Q. You can now say yes? A. Yes.

Mr. Biggins: That is all.

The Court: I believe that is all, Mr. Bowen. Thank you. You may leave whenever you wish.

(Witness excused.) [200]

MAX J. KUNEY, JR.

the plaintiff herein, called as a witness on his own behalf, being first duly sworn, was examined, and testified as follows:

The Clerk: State your name, please.

The Witness: Max J. Kuney, Jr.

Direct Examination

By Mr. Toole:

Q. How old are you? A. I am 42.

Q. What is your educational background?

A. I went to high school in Spokane, two years to the University of Washington.

Q. What subjects?

A. One year in the business school and one in engineering.

Q. Where are you working now?

A. Out of Spokane, I operate the Spokane office.

Q. What is the general nature of your duties in connection with the Spokane office at the present time?

A. I am in charge of that operation—in general charge of the office itself, do the bidding and estimating with hired estimators under me; in charge of the job organizations, staffing them and acquiring superintendents and foremen, and in general, equipment allocation as [201] needed on the job. All the things that it takes to run a construction business.

Q. Do you do this work under the supervision of your father?

(Testimony of Max J. Kuney, Jr.)

A. Not directly. Of course, we consult on matters of policy, but he doesn't live in Spokane and is not there to supervise that type of thing. That is a day-to-day full-time job.

Q. Is it accurate to say that you are running the contracting end of the business in Spokane?

A. Yes, that is accurate.

Q. Directing your attention to the time these family trusts were set up, at that time, I believe, the testimony was shown that your equity in the partnership was approximately \$500,000?

A. Yes.

Q. In the latter part of 1951, is that correct?

A. Yes, that is correct.

Q. When did you first consider the setting up of trusts for the benefit of your children?

A. It was several years after the close of World War II that I first started to think about trying to do something for my children and to realize that that was one way that something could be done. But it wasn't until Congress enacted legislation which appeared to me made [202] it proper and would not probably involve litigation, that I seriously considered taking that step.

Q. That seems to have been an error in judgment, doesn't it? A. I make a lot of them.

Q. Is it fair to say that the thought of establishing a trust occurred to you prior to the time it occurred to your father? A. I don't know.

Q. With whom did you consult professionally with respect of the establishment of a trust?

(Testimony of Max J. Kuney, Jr.)

A. With Bill Witherspoon of your firm.

Q. About when was that?

A. The first time I talked to him might have been about 1948 or '49, and he didn't think very much of the idea at that time. He thought you would have to go through court to establish a valid trust or establish the validity of it.

Q. Did you consult with Mr. Witherspoon following the enactment of the so-called Family Partnership Act? A. Yes.

Q. When was that? When did you consult with Mr. Witherspoon, approximately?

A. Some time along in 1951, I think after they had passed that Act and had some information on it. [203]

Q. Did you discuss with Mr. Witherspoon in his office the provisions that you wanted to have in such a trust?

A. Yes, in general so far as they concerned the powers and the duties of the trustee to protect the income and protect the children and their interests. I didn't discuss fine legal points with him.

Q. Did you have any discussions about what provision should be made for distribution to your children? A. Yes.

Q. Would you outline in general what your discussions were and your final conclusions?

A. Well, there were discussions on many alternate provisions as to when the principal would have to be paid or when income should be paid, and the things that a skilled attorney in trust matters would

(Testimony of Max J. Kuney, Jr.)

bring to our attention, and also, why, he pointed out that if there weren't some—if there wasn't a little discretion left in the hands of the trustee, these trusts could become a thing of danger to the children, possibly.

Q. How do you mean?

A. Oh, for example, with the trust for a little girl like my daughter, Caroline, who was two then, if she was absolutely—if there was an absolute requirement for the trustee, for example, say to distribute principal to her at age twenty-one, or something, she might [204] acquire a fortune-hunting husband. So that the trust would become a detriment in her life rather than an asset.

We discussed the various reasons why or the various things that could happen, and he suggested and I suggested rules that could be written into the trust to safeguard that to bring a third party in.

Q. Is it accurate to say that as a result of these discussions that it was your opinion that the provisions in this trust would be suitable for your family?

A. Yes, I thought they were.

Q. I am speaking of the provisions regarding the distribution of income.

A. Yes, I thought for the trustee to have the discretion to appraise the child, his developments, his interests, his occupational status, and his need, was desirable rather than something completely unrestricted with a person too young—anything could happen to a two-year-old. Maybe she has a mental condition by that time, who knows?

(Testimony of Max J. Kuney, Jr.)

Q. You were present in court yesterday and heard the testimony of your father with respect to the administrative provisions of the trust, the exoneration from accounting under the Washington Trust Act, and exoneration from judicial review? You discussed those matters with [205] Mr. Witherspoon?

A. Not in great detail. I believe I did notice some of them, and in some cases I asked him for an interpretation of what they meant and why they were there, and he gave me a reason at the time that he believed that possibly some things were rather standard to put in trusts of that type, and other things had some significance I hadn't grasped. He explained the points on which I raised a question, and I was satisfied.

Q. Did you direct him to put all of those administrative powers in there item by item? A. No.

Q. Did he submit them to you for your approval?

A. Yes, he submitted a draft of the trust, which he thought took care of the items we discussed that were desirable for the good of my children.

Q. Were you satisfied that the trusts finally prepared by Mr. Witherspoon would accomplish the object you had in mind?

A. I thought so at the time, yes.

Q. In the trusts created for Caroline and Jeff you named your father as trustee. What prompted you to consider him as a trustee of those trusts?

A. He is the grandfather of my children, and he

(Testimony of Max J. Kuney, Jr.)

knows them better than anybody else, aside from me, and I think as [206] long as he lives, he would be the best fitted person, aside from myself, to act for their benefit in a personal way and in a business way. He is the only person I know of outside of myself who could be induced to serve as a trustee who could still fully handle their financial interests in our business, because that is what I was doing, I was creating a partnership with myself for my children.

Q. Couldn't you have given something other than a partnership interest to the trustee so that it wouldn't be necessary for him to be an experienced partner in the contracting business?

A. What I wanted to do was give an interest in the business for personal reasons. We thought my son would come in with me. I wanted to do this in any event, but secondly, I didn't have anything to give him outside of the business.

Q. Did you have any outside investments, stocks and bonds of your own?

A. I have never invested in those things. I do have kind of a personal matter. I have got an investment in the Spokane Ski Club. I have got a thousand-dollar note or a bond of theirs. I think that is about the only outside investment.

Q. Everything else you have is in the partnership? [207]

A. That is right.

Q. When you considered appointing your father as trustee, did you or did you not expect him to use his judgment in the administration of that trust?

(Testimony of Max J. Kuney, Jr.)

A. I certainly did, as I have just explained. I appointed him trustee because I valued his judgment and wanted it.

Q. In reading the trust instruments you were aware that he had broad powers? A. Yes.

Q. Did you retain any powers to control or direct him in the trust instruments?

A. None whatsoever.

Q. Did you or did you not retain any power to control him in fact?

A. No, I don't control my father in fact.

Q. There were no side agreements?

A. No side agreements.

Q. Have you been satisfied with the manner in which he has administered the trust for your children? A. I have been so far, yes.

Q. Approximately what is the value of those trusts now?

A. I believe—may I refresh myself—I think it is \$215,000 in the trusts exclusive of their personal account.

Q. Have you got the figures there? [208]

A. Yes, it is about that.

Mr. Biggins: We will stipulate to the amount just given.

A. You are talking about the trust for my children?

Q. (By Mr. Toole): That is correct, the trusts for your children.

Mr. Biggins: I will stipulate as to the amounts. I think it is about \$215,000.

(Testimony of Max J. Kuney, Jr.)

A. It is about \$215,000 in John's trust, which I manage, and I am more familiar with that, and I think my children's is about the same.

Q. (By Mr. Toole): About \$215,000?

A. Yes.

Q. Are you satisfied with the fact that your father has left all of the assets of the trusts invested in the partnership?

A. Yes, I am satisfied with that investment. It has been paying. It runs about, I think, around 18 per cent compound interest after taxes so far, and I don't know where he could have done any better or anything approaching that for the same degree of safety and certainty as has been the record so far.

Q. Is it your understanding or is it not that your father could withdraw part of this investment from the family partnership and invest it [209] elsewhere? A. Of course he can.

Q. When I say "you," I think of you and your wife, Constance, as technically and legally as the donors, so I will just say "you."

Do you file federal gift tax returns?

A. Yes.

Q. And pay the gift taxes? A. Yes.

Q. As stipulated, you filed Washington State gift tax returns and paid the gift tax?

A. Yes, I did.

Q. And the government hasn't offered to refund the gift taxes? A. No.

Mr. Biggins: What was that?

(Testimony of Max J. Kuney, Jr.)

The Witness: I said no. He asked if the government offered to refund the gift taxes, and I said no.

Mr. Toole: Strike the question.

Mr. Biggins: I don't want it stricken.

Q. (By Mr. Toole): Did you participate in the decision to form the corporation in the middle of 1953? A. Yes.

Q. What factors prompted you to consider the advisability of organizing this corporation in the middle of 1953? [210]

A. Two factors, as far as I was concerned. For a long time we had a bonus arrangement or special partnership arrangement running with our general superintendent and our office manager, who had been this fellow Wiginton and Petersen, and I thought it would be desirable if there was some way in which they could have a reasonably substantial equity in the construction operations, and the corporation would accomplish that.

Q. In what way?

A. Where they could buy stock. However, if it wasn't an over-all corporation, the value would be too great for them to have a good equity. That was one consideration in retaining the fixed assets only in the family partnership, to reduce the size of the corporation.

Secondly, I liked the ease and convenience from a family partnership and trust standpoint of operating a business which only dealt with renting equipment, which was not concerned with the complexities of active construction work. And I thought

(Testimony of Max J. Kuney, Jr.)

about it, as, I believe, somebody read out of the Bible, that in case I die, it was a rather automatic business for my wife to be taken care of from the income which she would have from my portion of that partnership business. It would be a much more certain and simple thing for her to be involved in and not requiring her or her attorneys to look into [211] active operation. It would be a rather automatic business. Those were two considerations of mine.

Q. At that time you were also trustee of the trust for your half brother, John?

A. That is correct.

Q. And did you consider it as a wise thing to have the corporation formed and the operating assets taken out of the partnership from the point of view of the trustee also, or did you not?

A. Yes, I thought it was all right. In fact, I thought it was a good idea. Our business record is such that I can't recognize much risk in it, but if there is any risk, it certainly is in the operation, and from that standpoint it was even safer, and I looked at it as being absolutely fair, as we have done with other partners when we changed our business—to have a bigger interest in a smaller business, probably with the same over-all profit expectation, maybe a little better—I should say for the trusts to have a bigger interest. Maybe it was a little better protection all the way around, a little simpler business for a successor trustee when the time came for

(Testimony of Max J. Kuney, Jr.)

a corporate trustee to run that where he couldn't do much with that construction business.

Q. Passing from the considerations for the organization of [212] a corporation and turning for just a moment again to the creation of the trusts, was there or was there not any business reason for the creation of the trusts for Caroline and Jeff, in your opinion?

A. No, there wasn't any business reason whatsoever.

Q. What do you mean, there was no business reason?

A. Well, I wanted to take my children into the partnership, as I understood I was entitled to do by law. It didn't change the business.

Q. The general contracting business?

A. No, it did not, in taking those trusts into the partnership.

Q. It simply changed the persons who owned an interest in it?

A. It changed the ownership of interest. It didn't change the management at that time, and I certainly am unaware today if there is any requirement for a business purpose under this law.

Q. Now, directing your attention to the trust created by your father, of which you are a trustee, what is your concept of your duties as a trustee of that trust for the benefit of John?

A. I am in charge of it. I have got to run it, and from a business point, I have to watch that investment and see that I handle it to make as much as

(Testimony of Max J. Kuney, Jr.)

can be made for the [213] trust for his ultimate benefit and for him, and that I handle it with safety and with reasonable prudence as any man would do in any business he got into, and also I have to consider his needs, and possibly later on his desires, and when he is a little more mature, as to the distributions of income until he is thirty, and after that there is no question about a distribution of principal from the age twenty-one on.

Q. Where is Johnnie right now?

A. He is a first-year high school student at Cate's School down at Santa Barbara—Carpenteria.

Q. How old is he?

A. He is fifteen years old yesterday.

Q. And to complete the picture, where are Jeff and Caroline right now?

A. Jeff is a freshman at Washington State U, and Caroline is probably getting out for lunch from the fifth grade at Sacred Heart School in Spokane.

Mr. Toole: Your Honor, it is exactly twelve. My examination will take a little bit longer, and it would be convenient now to interrupt.

The Court: All right. We will recess until 1:30, ladies and gentlemen. I hope you have a nice lunch and keep in mind my admonition about not discussing the case.

(Whereupon, a noon recess was taken.) [214]

Afternoon Session

(Whereupon, on Tuesday, November 22, 1960, at the hour of 1:30 o'clock, p.m., all counsel heretofore noted and the jury being present, the following proceedings were had to wit:)

The Court: Go ahead, please.

MAX J. KUNEY, JR.

having previously been sworn, resumed the stand and testified further, as follows:

Direct Examination

(Continued)

By Mr. Toole:

Q. Mr. Kuney, at the time your daughter was going out to lunch we were discussing the concept of your duties as trustee for the trust and benefit of John.

To date where have the funds under your administration as trustee been invested?

A. They have been invested in the fixed assets in the partnership or loaned to the business on an interest-bearing basis.

Q. Do you consider yourself free to invest the funds in other investments when the occasion arises?

A. Certainly.

Q. Would the Bailiff hand to the witness Exhibit 29, please?

(Whereupon, a document was handed to the witness [215] by the Bailiff.)

(Testimony of Max J. Kuney, Jr.)

Q. Exhibit 29, being a letter to the Inheritance Tax Division of the State of Washington, dated August 7, 1953, signed by you, is that correct?

A. That is right.

Q. What matters were under correspondence between you and the Inheritance Tax Division at that time?

A. The amount of gift taxes to be paid to the State of Washington on the transfer of the partnership interests in trust.

Q. Is it correct that the valuation—value of the property given was under discussion?

A. Yes.

Q. Would you read the last paragraph on the first page of this letter, please?

A. "The gift made was exactly \$100,000, which at the date of gift was accomplished by transferring that amount of capital from the donor's capital account to the trustee's capital account, with revision of partnership interest in conformity. The trustee has the complete right to remove this \$100,000 from the firm and invest it outside the firm, and it is quite possible that he may follow such a course at a future date. Under the circumstances, we fail to see how the gift can be construed to be other than the \$100,000, which it was." [216]

Q. Thank you. During the course of the administration of this trust for Johnnie did you distribute any part of the trust income to Johnnie or for his benefit?

A. Yes. In 1952, the first year of the trust.

(Testimony of Max J. Kuney, Jr.)

Q. How was that distribution made?

A. It was accomplished by a ledger entry. He received \$18,000 some dollars, and, as I remember, the taxes were around seven.

Q. What was the net effect of this ledger entry that you speak of?

A. The effect was that he wound up with about \$11,000 after taxes in a personal account for him, which naturally came under the guardianship of his father, not me. It was personal capital at that stage, which was available for his needs or desires as his father would see fit.

Q. Do you understand what it means to be subservient to the will of another? A. I think so.

Q. Will you tell the jury what you understand by that term?

A. I think "subservient" means to, in effect, follow the will of another regardless of your own will or thoughts or desires, to be governed by those.

Q. As a trustee were you or were you not subservient to the will of your father in the administration of this trust [217] for Johnnie?

A. No, I have never been subservient to his will in the trust or otherwise during the years.

Q. Let me ask you this, in the conduct of the affairs of the Kuney family partnership how are you able to distinguish your obligations as a trustee holding part of the interest in the partnership and your obligation individually? How are your interests individually?

A. Well, I have never had any difficulty in rec-

(Testimony of Max J. Kuney, Jr.)

ognizing what my different obligations in a different position are any more than I was as a partner in Kuney-Johnson Company in recognizing my obligations there. I never tried to cause Kuney-Johnson expense for the gain of Max Kuney Company because I had a larger interest in Max J. Kuney Company than I did in Kuney-Johnson Company. It is no difficult problem to conform to several sets of obligations. I am accustomed to that.

Q. You are accustomed to wearing several hats?

A. Always for many years. I always had four or five partners in several different businesses at the same time.

Q. Has there been substantial disagreement between your father and yourself relative to important business matters?

A. Occasionally. [218]

Q. Could you give us an example?

A. Well, the most recent and perhaps the most important was in 1958 when he desired to establish a separate contracting branch in Seattle to do highway work after the dissolution of the other Seattle businesses, and at first I agreed with that idea because we planned it to be completely separate and autonomous, to have its own shop and own equipment, and he took in two outside partners outside our business, outside our family, and formed the company. But then he decided he wanted to run it with equipment from Spokane, that is, family partnership equipment and use it for piecemeal periods and return it, and we would not have maintenance

(Testimony of Max J. Kuney, Jr.)

facilities here for it. So I did not approve, and there was quite a considerable argument, believe me, but the ultimate result was that that company was dissolved, the other investors received their money back, and we did not go into the business here.

Q. Mr. Kuney, at this point I would like to revert to the emphasis that has been placed upon the fact that during the years 1955 and 1956 no rental income was paid by the partnership—paid by the corporation to the partnership, or, at least, it was suspended. I wonder if you in your own words could tell us the background and how the partnership and corporation arrived at that [219] position where there was a suspension of the decision to pay rental income in its determination?

A. Well, in 1952 we had a general partnership, which was contracting entirely, owned equipment, and we took in the trusts as partners, and we determined to split operating profits on the basis of capital equities, and that rental income would be computed at fifty per cent of the prevailing rates in the construction industry based on the periods of actual use, and 1952 was handled that way.

In 1953 we operated an over-all partnership for part of the year and then incorporated the business. The operating profits for that part of the year were distributed on a basis of total capital of the various partners. The rental was again computed just like the fifty per cent of the AED rates, as they are called, the going rate in the industry.

In 1954 we no longer had operating profits to

(Testimony of Max J. Kuney, Jr.)

consider, but the rental was divided on a basis of capital equities and computed on AED rates.

In 1955 I believe the same thing was originally done.

Q. Excuse me for interrupting, was that reflected on the first income tax return filed for 1955?

A. I believe it was on the original tax return for '55. [220]

Q. Rental income was paid by the partnership—by the corporation to the partnership?

A. That is my recollection. Then along in there we came into a Revenue Agent's examination of our entire business, and there were many contentions originally advanced, and amongst them was that the corporation could not be considered at all, that it was not valid for some reason, and that if it was allowed, why, no rental—the corporation was allowed to continue, but no rental should be paid on any equipment. We could only receive interest on the investment, and, furthermore, that if the corporation was allowed and rental was allowed, why, the corporation in fact owned certain fixed assets in Seattle, and the partnership didn't own them any more. They had been transferred to the corporation regardless of our intentions or our books or our corporate minutes, and that if the corporation was allowed, there was disagreement on the distribution of income between the partnership and the corporation, and that if rental was finally allowed by some superior authority, why, it could not be computed on the basis it had been because it was subject to our

(Testimony of Max J. Kuney, Jr.)

control to set down the periods of actual use. In other words, we might be dishonest, so some method would have to be devised that was honest or there was no possibility of [221] dishonesty, and there was a protest to this total capital being—total capital being considered as a basis for the basis of distribution for rental because the charge was made that all my father and I had to do as the senior partners with more capital, if we wished to increase the trust interests, was to just take out some capital. If we wanted to decrease the trust interests, we could, and if we could find it some place else, we could go outside and bring in some capital. That was subject to our control.

So we actually didn't know where we stood, and we had meetings and discussed the fact that when this was finally settled we would certainly have to set up some kind of system which would eliminate these objections which might remain. So we arrived at the concept that if the capital in the family partnership was only in fixed assets, that is the way the profits were divided, why, they couldn't charge us with juggling this money because we would have to sell the equipment that we needed in the business or buy equipment that we didn't need, and then the capital equities would still stay the same. It wouldn't change anything. That became fixed. Also, we determined we would have to have a method of computing rental that nobody could say we just made up in our own private way to get a total that [222] suited us.

(Testimony of Max J. Kuney, Jr.)

So we arrived at the fact that depreciation had to be approved by the Bureau of Internal Revenue, and the percentage of depreciation was something that was not subject to tampering with, and that would be a fair concept. But we didn't have any idea what percentage to apply because the Internal Revenue in going through all this went rather slowly, and until we had some idea of how much rental in total they would allow, we couldn't say what percentage of depreciation might be allowed, because it was still in the mill.

Well, some time about maybe in 1957 finally a lot of matters were settled, and the conferees in Spokane——

Q. Who are the conferees?

A. Well, they are kind of a first appeal board above the Revenue Agent Carney, possibly the appellate board in Seattle who were an appeal board above the conferees in Spokane, settled many matters. They settled that the corporation should be allowed. They settled that rental in addition to interest should be allowed. They settled that the partnership and corporate distributions of income were substantially correct. There were minor changes, and we have a figure to work with, and they also arrived—Mr. Carney's figures that he had arrived at, which changed our rental around one per [223] cent, but we now knew what was going to be allowed and was finally approved by the appellate staff in Seattle.

Q. On what date?

(Testimony of Max J. Kuney, Jr.)

A. It was in 1957 some time. I can't put it all together. Anyway, following that much information, we could then do many things to get our bookkeeping caught up, and that is what all this delay is about, and we finally knew the story. We could then issue stock to the partners. We at least knew we had a corporation. We could issue stock to the two partners that had been promised stock two years before. We knew we were going to keep on having it. We could correct an error we had in our own accounting wherein—in the concept that all the partnership capital was invested in fixed assets, it created a surplus.

My father and I were the only ones that had surplus, and we obviously had all the money in the stock. It was no matter for the trusts to be involved in, and everything we did along here was to really get our bookkeeping caught up as soon as we had enough information from the Bureau of Internal Revenue to be sure we wouldn't have to change it once more. I think really what happened here in '55 is that we originally set up this rental on the old AED system. Then we actually filed an amended return and just took all the rental out and [224] said, "At least, we haven't got it all in that particular year yet. We will give it a clean slate, and when we find out what we can have, we will make a new tax return for that year and go along."

But these matters weren't actually all settled for '52, '53, and '54, until very close to the end of 1957 or possibly early 1958, which accounts for the late

(Testimony of Max J. Kuney, Jr.)

dating of these entries to go back and pick up these years, that we didn't know what to do with this until we found out what happened to the years before. We had no basis.

I hope my explanation is clear. It is kind of complex, and that is all I know about it.

Q. And your story can be verified by the tax returns and the minutes? A. I believe so.

Q. You have refreshed your recollection by referring to those instruments?

A. In brief, yes.

Q. One point I want to develop, you testified, as I recall, that you decided that the profits should be divided between the trusts and the partners on the basis of their investment in the fixed assets?

A. That is correct.

Q. Why did that appeal to you as a superior method of [225] dividing profits rather than on the basis of their investing in the total investment in the partnership?

A. Well, number one, why, at least the fixed assets had a recognized value at the end of every year. You might say there was a value approved by the Bureau of Internal Revenue. They have to approve the depreciation schedule and all reductions and additions in value so that there was no tampering. The effect of it was to put the trusts all in the partnership and completely out of the corporation.

The effect of the total transaction, of course, was that they received a much larger interest in a

(Testimony of Max J. Kuney, Jr.)

smaller business with the thought that the profits would be probably fairly and evenly—that it would be a fair and equal transaction. It has worked out to be a little more than fair to them, but that is beside the point, too.

Q. If the profits are divided upon the basis of the investment and fixed assets, isn't it a simple thing to increase assets and decrease assets and manipulate all the control over the amount of assets?

A. It would be simple but foolhardy because to do so, we would have to either sell equipment we needed in the business to reduce assets or buy equipment we didn't need to increase assets. If we normally buy and sell, [226] it is in the normal course of our business. We sell what we don't need or what is obsolete, no longer useful to us, and we buy what we need to replace it.

Q. Have you ever made any decision to buy or sell fixed assets in the partnership for the purpose of changing partnership profit ratios?

A. Well, certainly not. That wouldn't be sensible. It would be very expensive to buy something you couldn't use.

Q. Have you ever considered the thought?

A. No, I have never considered the thought, and I believe I might be correct in saying as long as everybody has enough money to cover it, you wouldn't change the ratios anyway as long as everybody had enough money to cover the purchase coming out of their surplus accounts.

(Testimony of Max J. Kuney, Jr.)

Q. It has been pointed out in prior testimony that this division of profits on the basis of investment of fixed assets was recorded in the Bible in the year 1957 effective for the year 1955. Do you recall that testimony? A. Yes.

Q. That the profits were divided on the basis of a fixed investment and fixed assets for the year 1955? A. Yes.

Q. Do you recall the testimony that the date the Bible [227] bears in February 2, 1957?

A. I believe that is right.

Q. Was the decision to divide the profits on the basis of investment in fixed assets made prior to February 2, 1957, the date of the Bible in which these are first recorded?

A. Well, yes, certainly it would be made sometime prior to that. There was a decision made that a new method to meet the Bureau of Internal Revenue objections would have to be adopted way prior to that. Whenever we finally got the information which led us to believe that this system would be approved, it was agreed to implement it, and it may be that there was a time lag of a week or two in the writing up of the journal entry which you refer to.

Q. You don't mean to imply there was only a week or two before that that you decided to change the profit-sharing ratio?

A. No. A long time back we knew we had to change it. We didn't know quite how we would be able to do it. That is what I was attempting to develop in my earlier testimony. Until we had all the

(Testimony of Max J. Kuney, Jr.)

facts, as we kept getting Revenue Agent agreements, we were able to take another step which we thought would conform to the Bureau's—or would get the Bureau's approval. At least [228] it wouldn't be inconsistent and was something they previously allowed.

Q. At least it wouldn't be inconsistent with what?

A. At least it wouldn't be inconsistent with something which had previously been allowed back in those other years. That is what we are trying to find out about.

Mr. Toole: Hand Exhibits 24 and 25 to the witness, please.

(Whereupon, certain documents were handed to the witness by the Bailiff.)

Q. (By Mr. Toole): Are not these exhibits, Mr. Kuney, the agreements between you and your father as individuals and as trustees with respect to the division of profits made February 11, 1952?

A. Yes.

Q. Will you describe in your own words how the division of profits was made according to that agreement?

A. It was made on the basis of—after reduction of salaries for the active partners, it was made on the basis of the ratio of the capital account that they bore to each other, and that was the total capital account at that time.

(Testimony of Max J. Kuney, Jr.)

Q. What kind of business were you conducting at the time that agreement was entered into?

A. A general partnership. [229]

Q. There was no—just fixed assets in the partnership, it was a general contractor?

A. That is right.

Q. Do you agree that the agreement or that the manner of dividing profits in the year 1955 on is different than the manner of dividing profits between those two agreements?

A. The manner? No.

Q. The agreement with respect of—

A. (Interposing): The manner is the same, the details are different.

Q. How are they different? Let us be very precise and clear.

A. In those first years, that is what you are speaking of?

Q. That is correct.

A. As I say, we were a general partnership, and we considered total capital, including surplus capital, everything.

Q. In using the figures here for 1955, do you mean on the basis of each partner's investment in the \$1,325,000? A. Total, yes.

Q. In 1955 and in later years how was the rental income profit divided?

A. At that time there was a corporation. It was still divided on the basis of each partner's equity in the [230] assets of the partnership which were only machinery and equipment at that time. All

(Testimony of Max J. Kuney, Jr.)

other capital invested was surplus capital and was not considered, and any change in that surplus capital had no effect on the division of profits, which, I believe——

Q. Is it true or not true——

A. (Interposing): ——which I believe is still in conformity with this agreement.

Q. Is it true or not true that at all times you have endeavored to apportion the profits on the basis of capital investment? A. That is correct.

Q. One way or another?

A. As the capital investment changed, why, it would change like that.

Q. Have you been satisfied with this form of division of profits as trustee and as an individual?

A. It seems to me it would be quite clear cut and should meet some of the objections that we previously ran into or should meet them by defining capital, restricting it to the actual fixed asset investment and leaving no possible grounds for tampering.

Q. With the exception of the interest of the family partnership trust, has the Internal Revenue Service completed any audits for the year 1955 and later? [231]

A. We haven't had any reports. They have been out there from time to time working on it, but we haven't had any audit reports.

Q. When audits are eventually completed for the years 1955 and later years, will it be or will it not be necessary to make adjustment in your books?

(Testimony of Max J. Kuney, Jr.)

A. It depends on whether the audits agree with our books.

Q. And if they don't?

A. Then of course it will be necessary to make adjustments to conform. We will have to file amended tax returns to conform to the audit findings.

Q. Is it accurate or not to state that perhaps some time in 1961 or '2 you will be making adjustments affecting 1955 at this point?

A. It could be if there are any differences in the audit findings.

Mr. Toole: You may inquire.

Cross-Examination

By Mr. Biggins:

Q. May it please the Court, Mr. Kuney, sir, I take it in the heavy construction business over there in Spokane that the Kuney Company does deal with a rather large number of subcontractors?

A. Yes. [232]

Q. A number of which are partnerships?

A. Subcontractors, I assume some would be.

Q. Who meet their obligations to you periodically as they come due without any concern at all about their income tax status at the time? You are not concerned about the income tax problems of the subcontractors dealing with you, are you?

A. No, I am not.

(Testimony of Max J. Kuney, Jr.)

Q. And they are not interested a bit about your income tax problems, are they?

A. I presume not.

Q. And they have never inquired?

A. That is correct. It wouldn't be any of their affair.

Q. Now let us be very clear on these last two areas of testimony you have covered. What did I understand you to say was the original and basic understanding in 1952?

Do you have Exhibits 24 and 25 before you?

A. I did have.

Q. What was the understanding at that time on February 11, 1952, how partnership profits were to be divided? What did you say a few minutes ago?

A. By the total capital invested in the business.

Q. And at that time the amount of capital you had in the business did not equalize the amount of capital your [233] father had in the business, that is true, isn't it?

A. Well, that is right. I probably should back up.

Q. But nevertheless divided profits with him fifty per cent, that is true? A. Certainly.

Q. And not in accordance with the capital invested at all, that is true, isn't it?

A. (No response.)

Q. That is true, isn't it?

The Court: Answer the question.

Q. (By Mr. Biggins): That is true, isn't it?

A. Yes, sir.

(Testimony of Max J. Kuney, Jr.)

Q. Now, you were equally precise a few moments before that that you recall very vividly what was testified to on the Bible about how partnership profits were to be divided. Do you recall that testimony on that? A. Well, yes.

Q. What did you testify to a few moments ago how it was to be divided? What was the testimony you said you recalled very vividly?

A. I said I recalled it, but possibly you should refresh me.

The Court: Don't you now recall what it was that you said?

The Witness: What was the question I was [234]—question I was answering on the Bible, please?

Q. (By Mr. Biggins): He said, do you recall the testimony about the Bible where it provided about what the partnership agreement is? He led you. I didn't object, but then you testified, "Yes, I recall it vividly."

Now I simply inquire, Mr. Kuney, what do you recall so vividly? What was it that you recall so vividly? A. About the Bible?

Q. Yes, about the understanding or the agreement as to how profits were to be shared.

A. They were to be divided on the basis of the capital invested in the fixed assets of the partnership.

Q. All right. And that was what you testified to a moment ago, to be divided on the basis of the capital invested in fixed assets? A. Yes.

Q. Is that correct?

(Testimony of Max J. Kuney, Jr.)

A. Yes, I believe that is correct.

Q. All right. And if you care to examine journal entry four in the Bible, which I did read to Mr. Bowen, and where it states——

The Court: Let him have it so he will be satisfied you are reading it correctly.

(Whereupon, a document was handed to the witness by the Bailiff.) [235]

The Court: Can you give him the page or indicate what you are talking about?

Q. (By Mr. Biggins): Journal voucher four (indicating), Mr. Kuney.

A. Yes, I have it.

Q. Do you recall my examination of Mr. Bowen about what we call here the management directive where the Bible stated—do you see under “1,” “Active partners Max J. Kuney and Max Kuney, Jr., shall receive total compensation \$10,000 per year from partnership income to be divided equally between them and that the remaining income shall be distributed in proportion to each partner’s——” what?

A. “Capital investment in the partnership.”

Q. Now, do you recall in my examination of Mr. Bowen where I said, “Is it clear, Mr. Bowen, that this is the total, this \$1,325,000 is the total partnership capital?” Do you recall he said yes? Do you recall it or don’t you?

A. He may have said yes to that question.

Q. Well, your recollection isn’t vivid?

(Testimony of Max J. Kuney, Jr.)

A. Not completely. He probably did, though, if you say so, and I will take your word for it.

The Court: He is speaking about what he said here this morning. Don't you recall that? [236]

The Witness: I think he did, yes.

Q. (By Mr. Biggins): We distinguished most clearly the partnership capital, total capital investment in the partnership capital from the fixed assets in your testimony this morning, do you recall that?

A. I guess he did, yes.

Q. Now, in his testimony he said—his understanding was under this management directive from the Bible that income was to be distributed in accordance with total capital investment in the partnership.

Now, Mr. Kuney, what was your vivid recollection of the testimony that said it comes from fixed assets? Was your testimony inaccurate, or is there something in the record that I perhaps have missed?

A. No, that is my understanding of the capital invested in the partnership.

Q. I am not asking you your understanding. You said you had a vivid recollection of some testimony that said the distribution was on fixed assets and not total capital. I am inquiring now, Mr. Kuney, if I missed something in the record or was your recollection inaccurate? Have I missed something? A. I don't know.

Q. Now, we are satisfied that the Bible says, "Partners' Capital Investment"? You are satisfied now? [237]

(Testimony of Max J. Kuney, Jr.)

A. That is what the wording is.

Q. So we may be clear on some other testimony that was given this morning, you do recall, I believe, Mr. Bowen stating that he knew more about the books over there in Spokane than probably anybody else. Do you recall that? A. I recall that.

Q. Is it clear in your mind who wrote the Bible? Do you know who wrote the Bible?

A. My father made the basic entries.

Q. And he wrote that Bible in 1957, I believe?

A. Yes.

Q. Well, if you know, Mr. Kuney, if Mr. Wilson knows more about those books and adjustments than anything else, why did your father write the Bible, do you know? A. Mr. Wilson?

Q. Why did Mr. Wilson write the Bible—I am sorry, I have got the names all confused here.

The Court: Do you mean Mr. Bowen?

Mr. Biggins: Mr. Bowen.

Q. (By Mr. Biggins): Your father wrote the Bible, we are clear on that?

A. He prepared the adjusting entries which you refer to as the "Bible."

Q. It was Mr. Bowen who testified he knew more about the [238] accounts, he believed, than anybody else. Did you hear that?

A. Mr. Bowen is hired as an auditor and not as a bookkeeper.

Q. I realize that Mr. Petersen takes care of the books.

(Testimony of Max J. Kuney, Jr.)

A. I thought your question was why didn't he do the work instead of my father?

Q. Why didn't you ask Mr. Bowen to prepare the Bible? If you don't know, say so. Why did your father do it?

A. I think I do know. Normally we don't hire Mr. Bowen to do this kind of thing. He audits after they are done.

Q. Because the decisions have to be made, and you and your father make them, that is the reason?

A. And sometimes there are other corporate officers involved, too. That is the reason, yes. We have to run the business.

Q. I believe you will also recall that Mr. Bowen said in respect to the surplus capital accounts, which we were speaking of, and on redirect Mr. Toole asked him why they were used, and he said in effect, if you recall, "It is used—capital surplus accounts—it is used primarily as a basis for the method of determining income to be distributed to the partners." Do you recall that testimony?

A. Yes, I believe I do. [239]

Q. Is it accurate, is it true?

A. Yes, that is true.

Q. And you recall Mr. Coon testifying on the stand too, don't you, Mr. Kuney?

A. Mr. Coon, yes.

Q. And about the bank loaning the money and that?

A. Yes.

Q. And I asked him if it is true that the corporation ever pledged some of this property for

(Testimony of Max J. Kuney, Jr.)

the money that the corporation wanted to borrow at the bank? Do you remember a question such as that? A. Yes.

Q. And his answer was yes?

A. That is right.

Q. And that is true, isn't it?

A. That is true.

Q. And who does that property belong to?

A. It belongs to the various partners.

Q. But who is borrowing the money, the corporation?

A. The corporation is signing the notes on the money.

Q. And at that time did the children have any interest at all in the corporation? A. No, sir.

Q. Now, let us be clear on this, when I say "an interest in"—when I say, "who has an interest in the corporation," [240] who do you understand that I mean, say, in 1956? A. 1956?

Q. Who has an interest in the corporation?

A. Max J. Kuney, Max Kuney, Jr., W. R. Wiginton, and W. B. Petersen.

Q. If I say in 1956 who has an interest in the family partnership, what do you understand I mean?

A. My father and I, both as general partners and as trustee partners.

Q. Nobody else?

A. The family partnership, and that should be all.

Q. Excuse me? A. I believe that is all.

(Testimony of Max J. Kuney, Jr.)

Q. Where is Mr. Claggett? You did hear Mr. Coon say he thought he was a partner? You heard his testimony on that? A. Yes.

Q. You heard Mr. Henry's testimony that he thought Claggett was a partner?

A. Yes, I did.

Q. They were, of course, mistaken?

A. No, he is a special partner of the corporation. He shares in the profits of certain jobs.

Q. We are talking about the Kuney family partnership? A. You asked where he was.

Q. No, I didn't. I said the Kuney family partnership, who [241] do you understand has an interest in that?

A. I just said my father and myself both as partners and trustees.

Q. And, of course, when you filed the fictitious name—if you want to examine Exhibit 32—I believe it is Exhibit 35, Mr. Grant——

(Whereupon, a document was handed to the witness by the Bailiff.)

Q. (By Mr. Biggins): Now, on this certificate of firm name, which I believe you have before you, is dated March, 1953, isn't it? A. Yes.

Q. Do you see the date there? A. Yes.

Q. 27th of March? A. Yes, I see it.

Q. And that is your signature and that is your father? A. Yes.

Q. And up there above they are asking that the

(Testimony of Max J. Kuney, Jr.)

persons be listed, and you see the language, "having an interest therein"?

A. And their true and real names.

Q. And on this your name appears, doesn't it?

A. Yes.

Q. And your father's name appears there? [242]

A. Yes. They don't appear twice.

Q. And your father's name appears?

A. That is right.

Q. And there is nothing said about a trust?

A. No, it just means the persons conducting or intending to conduct the business or having an interest therein and their true names.

Q. And you used the expression "have an interest therein" a moment ago. You did include the children, though, didn't you, through you as trustee?

A. Included the trusts.

Q. Now, as I also understood your testimony before the noon recess, Mr. Kuney, the question was asked by Mr. Toole something like this, passing from the corporation now to the partnership—no, passing from the corporation now to the trusts, I am trying to read my shorthand here, was there a business purpose for creating the trusts, and you said no, there wasn't any business reason whatsoever.

We can go back if you don't recall.

A. Yes, I recall it.

Q. Now, wait a minute, it is true, speaking of the Bible again, and refer to it if you wish, that the Kuney family partnership was formed by the two

(Testimony of Max J. Kuney, Jr.)

adult Kuneys to reduce their income taxes while living, and to save [243] inheritance taxes at their death? That is true?

A. That is what that says.

Q. I know that is what it says, Mr. Kuney. It is true, that is what I am asking.

A. It is not complete.

Q. Shall I repeat it, it is not true?

A. I didn't say it was not true, I said it is not complete. That is what it says. It is true in part.

Q. Mr. Toole then asked—what do you mean by “business reason”?

A. Well, I wanted to take them in as partners, as I understood I was entitled to under the law.

Q. And when you said, “under the law,” you meant under federal income tax law, didn't you?

A. I was thinking of the 1951 Family Partnership Act.

Q. Now, it has been clear to you all along, I take it, Mr. Kuney, that the federal government has never questioned your right, power, and authority at all to make these gifts to your children? You have understood that, haven't you?

A. They haven't questioned the gifts.

Q. That is true, and do you understand now, don't you, that no matter what happens in this case, that that property still is your children's, do you understand that? [244]

A. I would assume so.

Q. The government has never tried to interfere with your family plans on what you do with your

(Testimony of Max J. Kuney, Jr.)

property? They never have to this moment, have they? You don't want us to get the impression they have?

A. They recognize your right to make a gift and pay taxes on it, certainly.

Q. And the only question at all we have here is the income taxes to be paid on the money earned under these agreements we are talking about, that is clear to you too, isn't it?

A. That is my understanding, yes. That is the question.

Q. And in talking this over with Mr. Wither-
spoon, or whoever your advisor may be, you knew and were advised and understood that you could create any kind of partnership you wanted under state law to be recognized under state law? You knew that, didn't you?

A. That wasn't all I wanted.

Q. And the additional thing you wanted is, as set out here, the Kuney family partnership was formed by the two adult Kuneys to reduce their income taxes while living and to save inheritance taxes at their death? That is at least part of it?

A. That is part.

Q. Now let us speak about your other testimony earlier when [245] you mentioned your ambitions, and very proper, sir, I have children too—your ambitions for your son, Jeff. Now, in speaking of these trusts, Mr. Kuney, I believe you said that one of your purposes was that if something should happen to you, it will not only take care of your chil-

(Testimony of Max J. Kuney, Jr.)

dren but the first person you mentioned, sir, was your wife, do you recall that?

A. In speaking of the trusts? I think what I——

Q. (Interposing): If something happened, and you were speaking about the work that Wiginton would do, the work Mr. Petersen would do——

A. I believe, and you may correct me, but I think the record should show what I was speaking of was the fact that the family partnership had only an investment in fixed assets, and my personal interest, which would pass to my wife, would still remain in that family partnership, which would be a risk-free thing and a good business. I was not speaking of my wife ever getting anything out of a trust, because that is impossible.

Q. No, but Mr. Kuney, is it clear that the trusts are not the only partners? You have an interest in the partnership, don't you? A. Certainly.

Q. And if anything——

A. I was speaking of my interest. [246]

Q. That is part of your estate?

A. That is right.

Q. Would you want to preserve and protect for the benefit of your wife if anything happens to you?

A. My wife and children, yes.

Q. And you examined and discussed with particular care the powers of the trustee and what would happen to the money, do I remember that correctly? A. Oh, yes, that and other things.

Q. And you noticed, of course, then in reading the provisions set forth in that trust, that if young

(Testimony of Max J. Kuney, Jr.)

Jeff happened to marry—and you do expect Jeff to grow up and get married?

A. That is correct.

Q. If he should grow up and get married and fail to have issue before his death, fail to have children, absolutely nothing is provided for young Jeff's wife, you knew that?

A. I am aware of that.

Q. All right. Now, my question, Mr. Kuney, is this, was there any idea—your idea or your father's idea or did you simply take the suggestion of a lawyer?

A. It was considered—Jeff's wife—he doesn't have one yet—I don't know her, and my greater affection right now might be toward my known daughter, because she would [247] succeed to his interest in the event Jeff died.

Q. Was it your father's idea or your idea or a lawyer's idea?

A. I can't say. I can't say we discussed it, brought the matter up. Who brought up the point first in suggesting nine years ago, I can't remember.

Q. But you became a partner when you became twenty-one, I believe, around 1940, with your father?

A. '39.

Q. Were you married at that time?

A. No, sir.

Q. Now, in providing for Jeff, as you say, your ambition was to bring him into this partnership?

A. Yes, I hoped he would.

Q. Now, as I read the instrument, which you

(Testimony of Max J. Kuney, Jr.)

said refreshed your recollection, as I understand it, he has no right to anything at least until he is twenty-one unless your father, Max, Sr., decides he can have some of it, isn't that right?

A. That is right.

Q. And in fact, your father has absolute power of discretion, or did have when the instrument was signed, to distribute all of the income if he deems necessary to your mother and to her parents?

A. While they lived if the need was there. [248]

Q. If he thought the need was there?

A. Yes.

Q. Regardless of what you might think?

A. That is true. He is the trustee.

Q. And give it to young Jeff only as and when he thought necessary? A. True.

Q. Now, I believe the first distribution made out of that was around 1952, you testified?

A. I think that is right.

Q. And to refresh your recollection, isn't it true that a tax computation was made first in 19—March, 1953, and then the distribution was made in April, 1953, after the tax computation was made? Does that ring a bell, or don't you remember?

A. No, I don't agree with that.

Q. You don't agree with that?

A. Not on the dating. I believe you will find that there were tax returns filed showing that distribution timely.

Q. Where would it be?

A. Our bookkeeping entry was made on April 3 when Petersen got it posted.

(Testimony of Max J. Kuney, Jr.)

Q. Let us be clear on "bookkeeping." When you mean "posted," we speak of posting from the journal to the ledger, that is posting? [249]

A. Even the journal entries were typed and taken off a worksheet, and possibly that is what that dating is. You will find the tax returns that were mailed on time on March 15 reflecting those distributions were made.

Q. Well, let us get at it this way, then, if we may. If you will look at Exhibit 27, sir, you will see, I believe, as I recall, in that letter that your father said that if he wanted any other distributions in this trust, that he would advise you in writing before the end of the year 1952? Isn't that in the last paragraph of that letter? Do I recall it accurately? A. No.

Q. May I see it?

A. The word "instruction" is not in writing.

Q. Does it appear at the bottom of the document, "If, as trustee, I deem it advisable to make any further distributions from the 1952 income of the trust to other persons eligible to receive such distributions, I will issue instructions prior to the end of the year 1952." That does appear here?

A. That appears.

Q. And no such instructions were given prior to the end of the year 1952, were they?

A. I can't recall now, but there were further distributions made for 1952, so I might have assumed they were. [250]

(Testimony of Max J. Kuney, Jr.)

Q. And on the books of the company those distributions follow several adjustments made January, February, and March, don't they? Do you recall?

A. Well, if you say so, I will assume so because I have looked and seen that they got the dating on the journal vouchers—was clear after tax returns had been filed and correspondence had been written. So it certainly indicates that the gifts were made ahead of the bookkeeping that got us caught up.

Q. And I believe your father testified that that ten thousand was very necessary in order to provide for the college education of your children? Was that the reason for this distribution, the college education? You heard your father's testimony?

A. You are on the distribution to who, now?

Q. The distribution made up at this first thirty thousand in their so-called personal account?

A. I assume he was speaking of why he made the distribution.

Q. But you and he agreed to work—to make a distribution before any distribution would be made at all, that is true, isn't it?

A. We discussed it, yes.

Q. And then agreed together—or do nothing if you couldn't both agree, then do nothing?

A. Not necessarily, sir. [251]

Q. Well, do you recall the letter that appeared in the Bible where we are talking about a gift, Mr. Kuney?

A. That has nothing to do with the trust, no.

(Testimony of Max J. Kuney, Jr.)

Q. I appreciate that. I am going to ask you about the letter now.

It is true you would not even agree to give gifts to your own children unless—do you remember the letter?

A. I remember that letter, and it has to do with personal gifts outside of the trusts.

Q. And depending on what your father might do, it would also depend on what you might do in in this letter?

A. In that case, that was true. It is spelled out clearly.

Q. Well, you seem to know all about it. What is the story behind this letter, Mr. Kuney?

A. That year we discussed the advisability of giving gifts to our children.

Q. What did the children need money for then?

A. Nothing.

Q. All right. Why did you discuss the advisability of giving them this money? It was around \$9,000, wasn't it?

A. We talked about whether or not we would feel in the financial position to take advantage of the \$3,000 annual exclusion which is allowable, and decided to do so [252] that particular year. I didn't go for it for '55. I did for '56, and I haven't since.

Q. It is clear, then, at least on this letter that the personal tax consequence to you and your father depended on whether or not a gift would be made to your children, not their needs, but your own tax?

A. Certainly.

(Testimony of Max J. Kuney, Jr.)

Q. All right. Now, your father, you know, has power to accumulate all income in these trusts for your two sons, for Caroline and Jeff, until they are twenty-one? Do you know that? A. Yes.

Q. And that after twenty-one he still has power whether or not to give them any income but has discretion whether or not to pay out for it, do you know that? That is Exhibit 2, if you want to look at it.

A. I believe he has got the power to distribute income to them at any time, hasn't he, whether they are twenty-one or not, but that he can't distribute principal until they are twenty-one, and he has to distribute income when they are thirty, isn't that right?

Q. You got the first two parts, "may distribute income until they are twenty-one."

A. Until they are thirty, I believe.

Q. Well, there are two ways to look at the instrument, and [253] he has power to distribute both income and corpus, if need be, until they reach thirty.

Let us go back to your way. He can distribute income until they are thirty, can't he, as he sees fit?

A. That is correct.

Q. And after they are twenty-one and until they are thirty, he may distribute corpus?

A. After twenty-one until they ninety he may distribute corpus.

Q. After they are thirty he must pay out current income to them? A. That is correct.

(Testimony of Max J. Kuney, Jr.)

Q. But he need not pay them out anything more than current income?

A. He does not have to.

Q. After they are thirty?

A. That is correct.

Q. Now, if your ambition was to bring Jeff into the business, why do we have all these strings attached until he passes thirty?

A. Solely for his own good because of his age and unknowns at the time the trusts were drawn.

Q. When you say his own good judgment, what your father thinks best for him even after he is thirty?

A. Whoever the trustee may be when Jeff is thirty. Perhaps [254] my father may not be here, in which case I would be successor trustee.

Q. And the trustee after your father passes away is who?

A. I would become successor trustee if I accept. If not, the Spokane and Eastern Branch of the Seattle-First National Bank.

Q. There is certainly nothing in writing in anything we have seen or heard about to this time in this proceedings about any agreement to make Jeff a partner in this business, is there?

A. As an individual, no.

Q. And all we have seen is the strings attached on this trust that he may get the income after thirty?

A. He must get the income.

Q. He must get current income, but nothing else?

A. Yes.

(Testimony of Max J. Kuney, Jr.)

Q. Now, the last two batteries, if I may, and would you get Plaintiffs' Exhibits 32 and 33, I believe, and take 32—we will just take Exhibit 32—my last battery, sir, you will know where I am going—my last battery is going to be the income tax trouble you mentioned with Mr. Carney. I certainly want to cover that.

Before we do get to that, you do recognize Plaintiff's Exhibit 32, the financial statement as of December 31, 1954? [255]

A. I do.

Q. That is your signature on it?

A. That is.

Q. And turning over to the next page, you have seen this letter?

A. I have.

Q. And turning over to the third page, you have seen that?

A. Yes.

Q. And on the third page it says and accurately states, the last sentence of the first paragraph of "Plant and equipment," it says, "The firm owns 206 pieces of major equipment having an original cost of \$1,230,702.38, which it uses in its business of heavy grading and excavating, rock crushing, paving, general building and electrical contracting."

You do see that sentence?

A. Yes, sir.

Q. All right. And it accurately states that the firm is using all 206 pieces of equipment, that is accurate?

A. Which it uses, yes.

Q. And the cost was over a million dollars?

A. The cost, yes.

Q. Now, at this point, speaking of the equipment used by the business, may we clarify, establish, and

(Testimony of Max J. Kuney, Jr.)

set aside once and for all what was the agreement between the family [256] partnership and the corporation on the use of equipment and fixed assets? What was your understanding of that agreement?

A. The agreement between the family partnership and the corporation as of what date?

Q. It did change, didn't it?

A. It certainly did. We had to change it.

Q. Well, let us say in 1952.

A. In 1952 there was no corporation.

Q. I am sorry. 1953 when the corporation was first formed. Of course, it is around May, I believe, or June first, 1953.

A. May 1 or April 30th.

Q. June 1, 1953?

A. Whatever it may be. Rental in those years until it was changed by the Bureau was computed, as I testified before, on the basis of fifty per cent of AED rental on the actual use records. Distribution was on the basis of capital equities to the capital at that time.

Q. And perhaps you will recall with me, because you said you did look at some of the journal vouchers, you will recall that we had in the profit computations machinery and equipment listed under assets and land and buildings, do you recall that?

A. Yes. [257]

Q. And that across from that assets we would have equipment with above it, "User, MJK Company." Do you remember entries something like that?

A. Yes.

(Testimony of Max J. Kuney, Jr.)

Q. "User, MJK Company."

A. "Fifty per cent," or something, "MJK."

Q. And, "User, Agutter Company"?

A. Fifty per cent, correct.

Q. Yes, it is fifty per cent. Now, what does the word "User" mean there?

A. That is the firm that is using the equipment that we, as partners, had an equity in, and the reason for the fifty per cent, that is all we owned in dollar value of that equipment.

Q. Please feel free to ask that I approach closer if you want to see this.

And the profit computations that we are making for the distribution of income between the adults and the trust is on the basis of the machinery and equipment used by the several businesses?

A. That is really—you can say—the other fifty per cent of, say, Kuney-Johnson was owned by Lloyd W. Johnson. We couldn't have very well paid the kids rent on that.

Q. May we be clear on this, it is equipment used, not [258] equipment or assets not used?

A. That is right, that is all used.

Q. It is used where we make this profit computation? A. Yes.

Q. Now, you are aware, I take it, being somewhat familiar with these tax laws, of the difference between property held as an investment and property used in the business? You are aware of that distinction, or are you?

A. Well, I can see that you can classify prop-

(Testimony of Max J. Kuney, Jr.)

erty as to whether you consider it to be an investment or consider it to be used in the business.

Q. May I be clear here that the property we are speaking about in determining this profit computation is property used in the business, is that right, or is that wrong?

A. Does that include—I don't know just what you are talking about. I think possibly that may include some investment. I don't know. Let me take a look.

Q. Perhaps Dun & Bradstreet, Exhibit 32, may help if you want it, but it is clear that it is property used by those businesses?

Mr. Toole: I don't know what Dun & Bradstreet, Exhibit 32, is.

Mr. Biggins: I am sorry, the financial statement identified as Exhibit 32.

Mr. Toole: It has nothing to do with Dun [259] & Bradstreet.

Mr. Biggins: That is right. I was mistaken.

A. Well, this is a schedule of fixed assets. The partnerships put it this way, and this is a schedule of the partnerships' total fixed assets, and whether they be rental——

What you are speaking of here is major equipment, which does not include land and buildings?

Q. (By Mr. Biggins): Look at Exhibit 32 a moment with me.

A. This consolidates several types of fixed assets.

Q. Look at Exhibit 32. You do include in Exhibit 32, if you will turn to Page 9, "Machinery and

(Testimony of Max J. Kuney, Jr.)

equipment, Schedule I," and you see the various items going over to Page 10? A. Yes.

Q. And going from Page 10 to Page 11?

A. Yes.

Q. And then on Page 11 we have totals, "Heavy construction division," do you see that?

A. That is correct.

Q. That is the total of assets used in the heavy construction part of the business? A. No, sir.

Q. What is it? [260]

A. That is the value of the equipment used in the heavy part of the business. If you will turn to Page 11 you will see the land and buildings held for business use, which are also fixed assets, with a further value on them.

Q. All right. I will take your characterization. But you do the same thing for the other divisions, don't we, the electrical division and the general building?

A. Yes, it is a consolidated statement. It has got everything in it.

Q. When we come to the very end of this on Page 12, we have there, "Land and buildings held for investment." Do you see that?

A. Correct.

Q. And that is not assets used in any of these heavy construction businesses, electrical business, or any of the others, it is, as stated here, "Land and buildings held for investment"?

A. "Schedule K," that is correct.

(Testimony of Max J. Kuney, Jr.)

Q. And that is the property located in San Francisco? A. That is right.

Q. And that is the reason that the Bible was changed in the amended return?

A. Because they forgot to get it included.

Q. Because they put finally in "Land and buildings held [261] for investment" in the fixed asset account? A. It is the fixed assets, sir.

Q. But not used as indicated on your journal vouchers?

A. There is nothing said about the nature of the fixed assets held by the partnership.

Q. My question will be a simple one, Mr. Kuney——

A. As to my requirement that they be used in the construction——

Q. My question will be a very simple one, after the Bible was written by your father, the accountant restored to the fixed assets and capital accounts, which had previously been classified in your financial statement of '54, land and buildings held for investment, that is true, isn't it?

A. It had been considered in the rental for 1954.

The Court: You must answer the question.

A. Yes, that is true. I am sorry, Judge. Yes, sir, it is true.

Q. (By Mr. Biggins): At the time your father prepared the Bible he excluded the land and buildings held for investment and only used the ma-

(Testimony of Max J. Kuney, Jr.)

chinery, equipment, land and buildings used by the going businesses? That is also true, isn't it?

A. That was discovered——

The Court: Well, no, is it true? [262]

A. Yes, it is true.

The Court: Please answer the question.

The Witness: I am sorry, your Honor. Yes, that is true.

Q. (By Mr. Biggins): Looking at Page 9, if you will with me, the very first item we see that shovel bought in 1936 for \$30,000?

A. Yes, sir.

Q. And we see under it we placed an engine in 1947 for \$6,000?

A. That is correct.

Q. Making an original purchase price of around \$36,400?

A. That is right.

Q. Now, at this time no rent was being charged on that piece of machinery by the partnership to the corporation although the shovel was—Strike that question.

This shovel was being used in 1954, wasn't it?

A. I believe so.

Q. All right. Was any rent being paid on it by the corporation to this partnership?

A. At this time, yes. It was listed in that schedule at fifty per cent of AED rates whether it had book value or not. The change was made for other reasons.

Q. Let us go to the later time. What changes did we have after the AED? [263]

A. That is when we tried to find a schedule that

(Testimony of Max J. Kuney, Jr.)

would meet with the satisfaction of the Bureau of Internal Revenue—I mean a formula.

Q. Let us take that up. You were the one, just as your father testified, that took care of the depreciation rates and the rental rates? That is true?

A. Yes, I believe so.

Q. And you did refresh your recollection on all this just as you said a few minutes ago? That is also true, isn't it?

A. That is also true, yes, sir.

Q. And the heart of the controversy we had at that time with the Internal Revenue Service, personified by Mr. Carney, was that the amount of rental charged was unreasonable? That was the heart of the matter you were talking about?

A. The first contention was that no rental was allowable at all.

Q. Well, depending on the business entities and recognizing the corporation now, as you said it was, the question was, what was the proper amount of rent to be charged?

A. Yes, after these other matters were resolved. That was the last one.

Q. And Mr. Carney said the rent you people were charging was much, much too low? He wanted to raise it? That is what he wanted to do, isn't it? He wanted to increase [264] the rate that the corporation was paying to the partnership?

A. I believe his final result was to increase it about ten thousand one year——

The Court: The question is, what was he assert-

(Testimony of Max J. Kuney, Jr.)

ing, Mr. Kuney. Please pay close attention to the question, and then we will get along so much better.

The question, as I understand it, was, was Carney asserting that a higher rental should be paid than you provided theretofore? Was he or wasn't he?

The Witness: At the time, sir, he was asserting that the rental was not correct. I was not sure of what his contentions were, whether it was too low or too high, until he finally turned up with an answer. That is my best memory now.

Q. (By Mr. Biggins): All right. You do understand after he did come up that he thought that this rental was not an arm's length transaction, you do recall that? A. Yes.

Q. And that the rental was unfairly low, do you remember that? A. He adjusted it upwards.

Q. Now, if the rent was increased as the result of anything [265] the Revenue Service might do, that would mean that further income would be distributable to the partners then, wouldn't it?

A. That would be correct.

Q. And if further income were distributable to the partners, you would have to pay more taxes, wouldn't you? A. Yes.

Q. And you realized that and appreciated it? You knew that? A. Yes.

Q. But there was nothing, nothing at all that Mr. Carney or anybody in the Service told you that would effect any change of anything you thought was due your children? They never tried to tell

(Testimony of Max J. Kuney, Jr.)

you at all how much should be given to the children, did they, for rent or interest or otherwise?

A. Yes, I think that was the effect of the examination.

Q. And the only reason this thing was held up at all was because you and your father wanted to make clear what your personal income tax consequences were going to be before we finally realized the agreements on what should be given the children? Now please fence, that is true, isn't it?

A. No, I don't believe so.

Q. Well, then, why didn't you finalize and crystallize what [266] you and your father were willing to give the children before you straightened out your personal tax matter with the Service? Why didn't you do it?

A. Our tax matters were both personal and as trustees engaged in a family partnership. You are attempting to create an occasional gift pattern, which I don't think—we weren't contemplating that. We weren't contemplating that.

Q. As trustee——

A. (Interposing): You see, we are running this family partnership as partners and as trustees for the benefit as partners of ourselves and trustees for the trusts, and it was a business, it was our duty to straighten out its income tax affairs.

Q. And so you held up all of this determination of what goes to the kids until that was straightened out?

A. We held up those determinations until some

(Testimony of Max J. Kuney, Jr.)

decision was reached that would let us arrive at a pattern which we thought would meet approval.

Q. Have you ever in any of your other business dealings ever held up a business deal such as that with other partners, other individuals, other corporations, until their tax affairs were straightened out? A. Yes, sir.

Q. Who and when? [267]

A. Techler, Agutter, Kuney-Johnson.

Q. In other words, the only other exception is in which the family partnership had at one time an interest?

A. That is the only business we have. You asked if we ever held up any transactions on other firms. That is all we are interested in.

Q. You do business with a number of subcontractors?

A. We couldn't affect their taxes, sir, their tax returns.

Q. You couldn't what?

A. I say we couldn't affect the filing of their tax returns.

Q. Who is "their"?

A. The subcontractors you are speaking of.

Q. You wouldn't expect to either?

A. I don't know what conduct we could take that would affect them.

Q. But you did in the case of this partnership with your children, you held up their distribution for years depending upon what the tax consequences were going to be here?

(Testimony of Max J. Kuney, Jr.)

A. Pending settlement of the initial years.

Q. And the argument at that time must be clear on this, the position of the Service was at that time that the rent was not high enough, the rent you were charging was too low?

A. I really didn't know until I saw the final—until I [263] saw the Revenue Agent's report three or four years later.

Mr. Biggins: That is all.

The Court: I believe that is all, Mr. Kuney.

Mr. Toole: Could I clear up one point, your Honor?

The Court: Yes, go ahead.

Redirect Examination

By Mr. Toole:

Q. What is a subcontractor in the subcontracting business, Mr. Kuney?

A. He is a person who takes, we will call it, a subcontract. He is an outsider unrelated who performs a portion of the work in a general contract, which we would hold, as distinguished from a straight supplier or a supply contractor. He is one who actually performs labor with his own crew on his own payroll at the site of the job instead of just supplying materials, and he takes a fixed price for his work.

Q. A subcontractor isn't a subpartner, is he?

A. There is no business relationship other than the contract relationship with any subcontractor.

(Testimony of Max J. Kuney, Jr.)

He signs the contract. He would have the same relationship with us as we have with the U. S. Government when we sign a [269] contract with them.

Q. Is there any interrelationship between income tax problems of the Kuney Company as a general contractor and the subcontractor?

A. None at all.

Mr. Toole: That is all.

Mr. Biggins: If the Court please, I did omit a matter.

The Court: Go ahead.

Recross-Examination

By Mr. Biggins:

Q. Could you look for a moment with me, Mr. Kuney, at the income tax return for the partnership for 1957 or any of them there? I happen to have 1957 before me, Exhibit A. Could you turn to what I believe is the last page, which is Schedule D, the gain and losses from sales or exchanges of property?

A. Schedule D?

Q. I believe it is the very last page, Mr. Kuney.

A. I got the schedule on about page 3.

Q. These are assets that had been used in the business up until the date indicated as disposed of or sold in this schedule, that is true, isn't it?

A. Yes. [270]

Q. Now, the first item there we have a Euclid truck that cost \$55,750—excuse me, a Euclid truck that cost \$8,600 approximately, don't we?

(Testimony of Max J. Kuney, Jr.)

A. That is correct.

Q. Which had been completely depreciated on the books of the partnership, the schedule right next to it?

A. Yes, I am just looking to get the headings up here.

Q. And it was sold for \$5,750?

A. Yes, sir, that is right.

Q. And we have another Euclid truck that cost \$14,800?

A. Yes, sir.

Q. Completely depreciated on the books and sold for \$5,750?

A. Yes, sir.

Q. And another Euclid truck for \$6,750 completely depreciated and sold for \$5,750?

A. That is right.

Q. Another Euclid truck, the same story?

A. That is right.

Q. And a Studebaker truck you purchased for \$2,000 and completely depreciated and sold for \$250?

A. That is right.

Q. And also the Chevrolet truck and the Ford ranch wagon?

A. Right.

Q. And the Cadillac?

A. Right. [271]

Q. And the Chevrolet truck?

A. Right.

Q. Two Chevrolet trucks?

A. I just got one more Chevrolet truck.

Q. I got the Chevy, No. 323.

A. Right. I got that one.

Q. All right. Now, there is a Ripper?

A. That is right.

(Testimony of Max J. Kuney, Jr.)

Q. And we got some kind of a power unit, \$10,500? A. Yes.

Q. A steam cleaner? A. Right.

Q. Another Euclid truck? A. Yes.

Q. All the capital gains realized, at least in issue, had been completely depreciated on the books of the company, hadn't they?

A. The capital gains haven't been depreciated.

Q. I am saying the depreciation has been claimed and allowed, and there was absolutely no book value on any items sold here? A. Not one.

Q. Not one?

A. Not one. You picked a good one.

Q. Now, in the agreement you ultimately reached or the [272] understanding that you had on the rental of this equipment by the partnership for the corporation was geared to the book value?

A. That is correct.

Q. And if we look at the 1954 financial statement, to look at the total on Page 2, for instance, Page 3, you did establish, did you not, for 1953—December 31, 1954, that the firm owned 206 pieces of major equipment having an original cost of \$1,230,700.02? That has been established, right?

A. That is correct.

Q. And the book value of that property at that time, if you take a look on Page 11, I believe, was less than two hundred thousand dollars?

A. Two hundred one thousand.

Q. Whatever figure you suggest, I will accept.

(Testimony of Max J. Kuney, Jr.)

A. Yes, a hundred forty, thirty-five, and twenty-six.

Q. Now, we have established that even though an asset is not on the books with a value, it is being used at this time in the business, we have established that? A. That is correct.

Q. We have also established in part, I take it, by the 1957 return that many of these pieces of equipment that have no book value on the books have a substantial market value? [273]

A. In some instances. The ones you see on the return are the selective group that had some market value.

Q. Take the shovel and dragline, the very first one, the purchase price was around \$36,000, wasn't it? Do you remember that? A. Yes.

Q. The very first item? A. Excuse me?

Q. Page 9. A. Yes, sir.

Q. \$36,000. We sold that in 1958 for \$20,000, do you remember that?

A. I remember selling one in 1958. It could be that one.

Q. For around \$20,000?

A. I don't remember which one I sold or whether it is the one that says, "1949, one shovel."

Q. The one in 1949, to refresh your recollection, that was sold for about \$35,000?

A. That is what I was thinking.

Q. And the book value here is less than \$3,000?

A. What?

Q. The book value.

(Testimony of Max J. Kuney, Jr.)

A. \$7,091, I think. You are looking at that Lima 1201 diesel. I was looking at the other, the Northwest.

Q. The book value is less than \$3,000 in [274] 1954? A. That is right, on the 1201.

Q. That was sold five years later, January 14, 1959, for \$35,000. A. Very true.

Q. And I take it, it is true, as I suggested, Mr. Kuney, that all of this equipment is not—it is all not only being used, but also, even though it has no book value, it has substantial economic value?

A. Some does, some doesn't at this stage. Some of that stuff has been scrapped off.

Q. Some what?

A. Some items have been just scrapped and lost. I mean some of those things actually disappear.

The Court: No, not any of these items here listed.

A. Not to that date, but I mean I thought the question was "still has value." There are some of the things that just—we have them that are no longer listed.

Q. (By Mr. Biggins): My final two related questions, the rental agreement you ultimately adopted was geared to the book value?

A. That is correct.

Q. And applying that, if we may, to this statement, because it is before us, that would apply to—not to the million two hundred thousand [275] dollars? A. That is correct.

Q. But to the \$200,000?

(Testimony of Max J. Kuney, Jr.)

A. That is correct.

Q. Which means rent is not being paid on most of the equipment that is being used, that is true, isn't it? Most of the equipment that is being used is rent free under this agreement you are talking about?

A. That is entirely correct.

Mr. Biggins: That is all.

The Court: Is there anything further?

Mr. Toole: Yes, your Honor.

Redirect Examination

By Mr. Toole:

Q. Is the equipment being used without payment of rent? Is that what I understood you to testify?

A. The older equipment which has no book value, of course, automatically does not directly receive rental payment. We consider it to be a fair arrangement in that it requires the user corporation to excellently maintain that equipment and keep it up so that it has useful life after its book value has expired.

Q. Is it true or not true that this depreciation plus thirty per cent is the manner of computation of rent for all of the equipment? [276]

A. It is the total book value of all the equipment.

Q. Would you like to have some arrangement with the Internal Revenue that they stop questioning it so you could compute it once for all?

A. That is what we thought would satisfy them.

(Testimony of Max J. Kuney, Jr.)

The result of this 130 per cent application approximated Mr. Carney's final findings. You see what he did, he changed our rental for two years by \$4,800. It was inconsequential, but we didn't realize that it was going to be inconsequential. We didn't know whether he had it high or low. When we got the word, we took a look and devised a formula.

Q. The formula appears to be under criticism by the Internal Revenue Service this afternoon?

A. It does.

Mr. Toole: That is all.

The Court: Is there anything further?

Mr. Biggins: No.

The Court: That is all, Mr. Kuney. Step down, and you are excused.

(Witness excused.)

Mr. Toole: The plaintiff rests.

The Court: Ladies and gentlemen, we will have the afternoon recess at this time.

(Whereupon, the jury withdrew from the courtroom.) [277]

Mr. Biggins: The government now moves to dismiss on the grounds of failure of proof, and wishes to file with it a written motion for directed verdict.

The Court: I have very serious questions about whether or not this motion ought not to be granted, but in view of the fact that we have taken this much time to present the matter thus far to the jury, the motion will be denied with a specific reservation

that the Court will consider the motion further following the verdict if the matter requires any further consideration.

Now, I will expect you to go forward with any additional proof or consider whether you want to put any proof, and then depending on how long that is, I think what we will do is take the argument this afternoon, and I will then charge the jury the first thing in the morning.

Recess.

(Whereupon, a short recess was taken.)

Mr. Biggins: We have some very brief testimony, your Honor.

The Court: Put it on, please. [278]

FRANCIS A. CARNEY

called as a witness on behalf of the Defendant, being first duly sworn, was examined, and testified as follows:

The Clerk: Please state your full name and spell your last name, sir.

The Witness: Francis A. Carney, C-a-r-n-e-y.

Direct Examination

By Mr. Biggins:

Q. Where do you live, Mr. Carney?

A. I live in Spokane, Washington.

Q. And for how long?

A. I have lived there continuously since World War II.

(Testimony of Francis A. Carney.)

Q. And your business or profession, Mr. Carney, what is that?

A. I am an Internal Revenue Agent with the Internal Revenue Service.

Q. And have been for how long?

A. Eleven years in December.

Q. And in your employment capacity as Revenue Agent did you have occasion to examine the tax returns of Mr. Kuney and the various corporations for the years involved here? A. Yes. [279]

Q. Are you the agent that was mentioned in the testimony here as Frank Carney? A. I am.

Q. Now, please pay attention to my question now and to the limitation in my question, Mr. Carney, because I don't want to rehash the whole thing.

Did you hear the testimony about the dispute as to the rentals involved in these years? Did you hear that testimony? A. I did.

Q. Were you at the conferences to negotiate with these people on the rental problem discussed?

A. I was.

Q. What was the problem there, and will you relate very briefly in your own words what was this dispute about the rent?

A. After my examination of the books and records of both the corporation and the partnership, and comparing the income and expense over a period of one or two years, of two years in this particular, I had come to the conclusion that the corporation had not paid the partnership as much rental as it would normally pay doing business with a stranger,

(Testimony of Francis A. Carney.)

or, as we say, on an arm's length basis. My finding was that the partnership had not received enough rental for the equipment used by [280] the corporation during the corporation's fiscal year ended April 30, 1954. My finding was that the corporation had paid some \$29,000 less rent to the partnership than in my judgment it should have paid.

Q. When you say \$29,000 "in my judgment," were you trying to give them the benefit of the doubt or not the benefit of the doubt?

A. Yes, I did give them the benefit of the doubt because in my computations I considered the fact that the corporation also maintained the equipment and went to some expense, and I made a thirty per cent allowance for that item or for that element of expense. In other words, I reduced the \$29,000 down to what I thought the corporation should have paid in addition to what they did, considering all of the other factors.

Q. Now, being very careful to note my question again and its limitations on the rental issue, the position in your examination was that they had not paid enough rent, do I understand that correctly?

A. That was my position.

Mr. Biggins: That is all.

The Court: Cross-examine, please.

Mr. Toole: No inquiry.

The Court: That is all, Mr. Carney. Step down.

(Witness excused.) [281]

The Court: Call another witness.

Mr. Biggins: The government rests, your Honor.

The Court: Very well. Ladies and gentlemen, we are going to go ahead with the argument of the case this afternoon, and then I think that will carry us to a point where we will suspend and have you come back in the morning, at which time I will give you the instructions in the morning, and you will have the case the very first thing. I think you would all find that more agreeable, although some of you might want to be finished tonight. But in any case you will get the case the very first thing in the morning, which should give you ample time to attend to your duties in connection with it without interfering with your affairs unduly.

Now, if you will take just about a five-minute recess, then we will be ready to go forward. I wish to offer my apologies for having you run up and down the stairs, but I thought there would be a little more testimony than this.

(Whereupon, the jury withdrew from the courtroom.)

Mr. Biggins: If I may indicate for the record, I gave to Mr. Grant the renewal of my motion for directed verdict. [282]

The Court: The record will show a motion of defendant for a directed verdict has been interposed at this time, and the same ruling will be made thereon as was made to the motion to dismiss; namely, that it is denied, exception allowed, with the reservation that the Court will give it further

attention if the verdict in the case indicates it needs to be considered further.

(Whereupon, the Court advised counsel as to the nature of the jury charge.)

(Whereupon, with the jury present, oral argument of counsel was rendered.)

(Whereupon, at 4:35 o'clock, p.m., the court recessed.) [283]

Wednesday Morning

(Whereupon, on Wednesday, November 23, 1960, at the hour of 9:45 o'clock, a.m., all counsel and the jury being present, the following proceedings were had, to wit:)

The Court: Ladies and gentlemen, as I explained to you yesterday, the next phase of the trial consists of the instructions of the Court to the jury concerning the law applicable to the manner in which the jury conducts its deliberations, and the principles of law upon which the facts of the case are to be considered and applied in reaching the verdict. I think I mentioned especially to you at the time that the case started that in every case where a jury participates in a trial, it is the function of the jury to decide the facts, and in that field the jury are the final and absolute authority. The judge may, if he sees fit, in this court, comment about the facts or suggest to the jury wherein he, the judge, thinks the weight of the evidence may lie. But even if the judge does that, the jury are not obliged to agree

with the judge on questions of fact. Indeed, they are obliged to follow their own judgment and intelligence and experience on the matter of facts, and so it is here. [284]

On the other hand, with respect to the matter of law, the principles of law, there the jury are obliged to accept what the judge says the law is and apply those principles as best they can to the facts they find from the evidence in the case.

I am not going to comment about evidence or the facts and have not consciously or intentionally done so throughout the trial, nor will I do so in this charge for the reason that the basic fact issue here is one that I am well satisfied you twelve people, who will sit upon the case, are as well or better able to consider and decide than I as an individual would be. The twelve of you will have a variety of experiences in life far beyond anything that any single individual could have, and that, of course, is the virtue of the jury system. It brings a wide variety of talent and experience and ability into the matter of resolving fact issues, which it is thought by the law are peculiarly questions for lay people with practical experience in life to settle and determine. Therefore, if it seems to you that anything I have said or done during the trial or in the giving of these instructions is intended to incline you one way or another on any fact question, please be sure that you must have misunderstood or misinterpreted what I have said or done, because I [285] do not intend it to be such. I think this issue is a simple issue which you will have no difficulty at all in

resolving rather promptly from the evidence you have heard here. But whether it be so or not, I do not intend to tilt you one way or another in the decision you are to make.

Now, in this court, as is true generally of federal courts, the instructions are given to the jury orally in the manner that I am giving them to you now. In other words, you will not receive any booklet or pamphlet or transcript of what I am saying, and I will give them to you only just this once. Now, this of course places a heavy obligation upon me to present the instructions to you as simply and understandably as the subject matter will permit, and it places upon you the responsibility of listening closely and attentively so that you will have in mind the principles of law that are to be applied in your deliberations in the case.

In general I try to make instructions in each case as brief and concise as the subject matter will permit. Sometimes in some types of cases that is difficult to make them very brief, and in others they can be quite brief. In this particular case I should think I would classify them as medium, perhaps. However, I will say this, that the subject matter of the charge here is what [286] I am sure a layman would think of as being technical. As a matter of fact, most matters relating to tax law are rather technical in nature, and therefore, I have tried to couch what I am about to tell you, as near as may be, in lay terms, and wherever I depart from lay terms, I try and define them for you even at the risk of cover-

ing something that you already know. I hope you will not take affront if I should do that.

The instructions that are now given you must be taken as a whole and not as separate things unrelated. The whole of the charge given to you must be considered as a whole. In other words, you must not pick out some particular thing as said at one time or another and go away with it, as they say, "be carried away with that," without giving thought to all that is said, because the instructions are intended to be an integrated whole, all parts of which are to be considered in connection with all other parts.

Now, the plaintiffs in this case are Olive R. Kuney and Max J. Kuney, Sr., and Olive Kuney at the time we are here concerned with was the wife of Kuney, Sr., and the other parties plaintiff are Max Kuney, Jr., and Constance Kuney, his wife. I will not hereafter refer to either Olive or Constance particularly. They are parties by virtue of their marriage to the men involved, [287] and I think for convenience sake, if I just simply refer to either Senior or Junior, or Kuney, Sr., or Kuney, Jr., you will understand that I am then referring to both the husband and wife in each instance wherever applicable.

These plaintiffs have brought these three separate suits in which they seek a refund of income taxes previously assessed against them, and upon which assessment paid by them under protest, and they now seek to recover back these taxes, and, therefore, we refer to this kind of a case as a refund

case. The total recovery sought here is some \$83,000 odd with interest, and so on, which the plaintiffs claim they were required to pay by reason of the assessments, but which they claim was not properly due and owing them under the facts and the tax law applicable.

The suits are brought against Mr. Frank in his capacity as District Director of Internal Revenue and as a representative of the agency of the United States to whom the taxes were paid; namely, the Treasury Department of the United States.

Now, the fact that the plaintiffs on the one hand are private individuals and Mr. Frank is or was an official of the United States, in and of itself, of course, has no relevancy or bearing to the issues in the case and should not be entered into or affect your verdict [288] in any way. In other words, all persons under our law, whether they be private individuals or officials of the government, or whomsoever they may be, it does not make any difference, high, low, medium, rich or poor, under our law all are exactly equal before the law and all are entitled to equal and exact justice regardless of what their situation in life may be, and, of course, you must treat them as such in your deliberations here.

The plaintiffs having brought the action for the refund of these taxes, the burden rests upon them to establish by a preponderance of the evidence that they are entitled to refunds that they seek. Now, if you are satisfied from the evidence and under the law, as I will give it to you, that the plaintiffs have established their claim to refund by a preponder-

ance of the evidence and under the law, then, of course, they are entitled to recovery. On the other hand, if you find that they have not so established by a preponderance of the evidence their right to the refund, then, of course, they are not entitled to the refund.

The term "burden of proof" as I have just used it means the burden of producing evidence which fairly preponderates over the opposing evidence. It is not necessary that a party having the burden of proof on a particular issue in a given case should establish that [289] solely by evidence that such party himself produces or by witnesses called by such party. In determining whether or not a given party has carried the burden of proof resting on such party, you must consider all of the evidence in the case, whether it came out from witnesses called by one side or the other, whether it came out on direct or cross-examination, or however it was produced, in determining the issue.

The term "preponderance of the evidence" means the greater weight of the evidence. It is not necessarily determined by the number of witnesses who may have testified on one side or another since you may be convinced of a given fact by the testimony of a single witness as opposed to that of several witnesses, or by something coming in on cross-examination of a witness, which may satisfy you of the fact in the matter even though on direct examination the same witness or other witnesses on direct or cross testified to the contrary. What I am

trying to say here is that the preponderance of the evidence in a civil case means the excess of the weight of the value of the evidence, and it is that amount of evidence which turns the scale either one direction or another, which were evenly balanced before the introduction of the evidence.

Now, if upon a fact issue in the case you [290] find that the evidence is evenly balanced and that the scales have not been tilted one way or another, then, of course, on that fact issue you must find against the party having the burden of proof because, obviously, there has been no preponderance nor any tilt of the scales one direction or another. Then on that fact issue it must be found against the party who has the burden of establishing the fact.

Your verdict must be based entirely upon the evidence which has been presented in the course of the trial, and regardless of whether it comes out from witnesses on one side or the other, whether it came out on direct or cross-examination, and you should not discuss or consider anything but the evidence in your deliberations. The statements of attorneys in the case made during the trial either in the opening statements or in the arguments are not evidence and do not tend to prove anything that they say, and it should only be given consideration by you insofar as what you say is in accord with your judgment of what the evidence was in the first place, and what weight and significance and value you attach to it.

In general evidence is divided into two classes.

The one class is called "direct evidence" and the other we call "circumstantial evidence." [291]

Direct evidence is that given by witnesses whose testimony purports to be based upon direct, personal hearing or seeing or observation. That is direct evidence.

Circumstantial evidence means indirect proof, that is, the proof of certain facts and circumstances from which other facts and circumstances at issue in the case may reasonably and logically be inferred. In other words, it is the inferences and conclusions to be drawn from the direct evidence itself. Circumstantial evidence, of course, is not to be rejected or denied consideration merely because it is such, but it should be carefully scrutinized and considered. Under no circumstances should you indulge in guesswork or speculation or conjecture, but you are permitted to, and, indeed, it is your duty to draw such logical, reasonable and fair inferences from the direct evidence in the case as you in your judgment fairly think them entitled to receive.

You must give such weight and effect to such inferences whether in favor of the plaintiff or in favor of the defendant as you deem them entitled to receive. Circumstantial evidence in the case may be as conclusive in its convincing power as direct evidence. When it is strong and satisfactory, the jury should so consider it, neither enlarging nor belittling its force. In other words, it should have just and fair weight with you, [292] together with all the other evidence in the case.

Now, the ultimate question for your determina-

tion in this particular case is as follows: On the consideration of all facts and circumstances shown by the evidence and under the law as given you by the Court, do you find the status of Kuney, Sr., and Kuney, Jr., in their trustee capacity, separate and apart from their personal capacity, as partners in the Kuney family partnership genuine, bona fide, and valid for income tax purposes? That is the ultimate question.

The form of verdict to be given to you will be in those precise words, and you will answer that question yes or no, and that will be your general verdict in this particular case, because all issues in the case hinge upon that ultimate determination which you must make from your appraisal of the evidence that has been given to you and the law as I will state it to you now.

The general principles of law which are applicable to this question and which you must apply in reaching the answer are as follows: The tax laws of the United States provide that if an individual makes a bona fide gift of a partnership interest in a business to a member of his family or to a trust for the benefit of a member of his family, the income thereafter derived from this capital interest will be taxed to the donee, family member, or [293] trust, so long as he or it is the genuine owner of such interest.

However, if the gift is merely such in form but not such in fact, or if the donor has retained so many of the incidents of ownership that he continues to enjoy substantial ownership or control of

the property which he purports to have given away, even though the gift be valid as between the donor and donee, the interest of the donee will not be recognized for federal income purposes. In such case the donor is treated as though he were the actual owner of the partnership interest rather than the donee and the income derived therefrom is taxed to the donor rather than to the donee.

Now, I think the words "donor" and "donee" are pretty obvious what their meaning is, but simply it means that a donor is a person who makes a gift or donation, whereas, the donee is the person who receives the gift or donation.

Under our law, our federal law, a partnership itself and as such pays no income taxes. Rather, the law requires each of the partners as individuals to report and to pay taxes on his respective share of the net income of the business. The partnership as such merely files what we call an information return; that is, a return which reflects the business operations of the partnership during [294] the tax year by way of information but not as a basis for the payment of tax by the partnership as such, and consequently this type of return is commonly referred to as an "information return."

As far as we are concerned in this tax case, a partnership may be defined as an association of two or more persons who agree to share the profits of a business company which are produced by their services or by their capital used in the business. In family partnerships or trusts, there must be particularly scrutinization for tax purposes of the alloca-

tion of the income among the family members. This is because of the possibility that those who are closely related in kinship may attempt to secure tax advantages by income splitting through the operation of profitable business enterprises in partnerships or trust form although they are not actually such in substance.

The basic requirements for recognition of a partnership as bona fide for tax purposes are: (1) The existence of genuine intent on the part of the participants to actually carry on business together as partners, wherein each is the true owner of capital used in the business or furnishes services useful to the partnership business, and, (2) having such intent that they conduct the business in accordance with a genuine partnership [295] relationship.

Whether a purported trustee ownership of a capital interest in a partnership is bona fide, and whether the purported trustee-partner has actual dominion and control over such interest must be ascertained from all of the facts and circumstances shown by the evidence in each particular case. The bona fideness of the purported ownership is not shown simply by the fact that legally sufficient documents of transfer have been executed nor by any other formal or specific test.

For example, in the present case there is no issue as to the validity of either the partnership agreement or the trust document under the law of the State of Washington, but the question is whether this relationship was valid for tax purposes in the years that we are concerned with; namely, 1952,

'53, and '54. That question is a separate and distinct matter from the question of whether or no the partnership agreement and the trust agreement were validly executed.

The facts found in each particular case, when taken as a whole with respect of the several following matters, comprise the basis upon which the ultimate determination of bona fideness must rest. In other words, I will now enumerate to you a variety of the factors that are to be considered in the light of the evidence you [296] have heard in reaching your ultimate decision on the question of whether or no your answer should be yes or no to the ultimate question I have already read to you. These factors or elements, if you want to call them that, are, one, whether or not there was a retention by the donor of controls, either direct or indirect, over income distribution, assets essential to the partnership business, management powers beyond those common in ordinary partnership relationship, or restrictions on the donee in the sale or liquidation of his interest without financial detriment.

Second, whether or not there were indirect controls exercised by the donor through either a separate business organization, estates, trusts, or those of individual or family relationships or by any other means.

Third, whether or not the donee participates in the management of the business or in performance of services to the business.

Fourth, the manner of making partnership income distributions, how they were paid, how they

were determined to be paid, to whom they were paid, when and how they were used and controlled.

Fifth, the actual manner in which the partnership business was conducted after the creation of the purported trust or partnership and trustee relationship. With respect of compliance with state or local statutes concerning [297] partnership business, fictitious names, business registration, and the like.

Control of business properties, assets, bank accounts, who had them, how was it exercised, the recognition or otherwise of the donee's right in the distribution of partnership profits, and profits, the recognition of donee's interest in business contracts, insurance policies, other matters affecting the partnership business, the existence of written agreements, records, or memoranda contemporaneous with the tax years in question establishing the nature of the partnership agreement and the rights and liabilities of the several partners, the filing of tax returns as required by law, and the existence of any oral agreements with respect of the partnership business insofar as shown by the evidence.

Sixth, the reasonableness or otherwise of the salaries and other compensation paid to partners in relationship to the services rendered by them in and for the partnership business, and, finally, whether or not the business itself benefited by reason of the entrance of the new partners into the business; that is, whether or not there was a true business purpose for the formation of the partnership.

These are the factors and elements insofar as

they may be shown by the evidence and your determination [298] of the facts concerning them which may and should be taken into account in reaching your ultimate conclusion as to the bonafideness of the relationships claimed by the plaintiffs to entitle them to the refund they seek in these actions.

Now, any taxpayer, whoever he may be, has the legal right to decrease the amount of taxes he may be required to pay by any lawful means or any means permitted by the law. The fact that one of the taxpayer's motives in transacting business in a certain manner to avoid taxation, if he can, will not in and of itself establish his liability for the taxes he may have avoided, if lawfully and otherwise validly done. However, the presence or the absence of a tax avoidance motive is one of the several factors to be considered in determining the reality or the actuality or the bonafideness of the ownership of the capital interest acquired by gift and the genuineness for tax purposes of the transaction and of the partnership.

There is no rule in the law of partnership which, in and of itself and standing alone precludes a trustee of a trust from being a partner in a family partnership. Where a partnership interest acquired by gift is held in trust, the trustee may be recognized as a partner for income tax purposes if his dominion and control [299] over the interest is such that he in his fiduciary capacity as trustee is the true, actual, and genuine owner thereof. However, the validity of the trust and of the trustee as a

partner in the partnership must pass the dual standards relating to the family partnership and the trust rules.

A valid trust is an entity separate and apart from the trustor or grantor, and “grantor” or “trustor” means the same thing, the trustee and beneficiary. It is a separate, legal entity then separate and apart from the several parties who may be connected with it. The trust as such files a separate fiduciary return reporting all of the income which it has received and accrued and pays a tax on the income which it accumulates for future distribution to trust beneficiaries. In this particular, you see, a trust is different than a partnership. Trust income which is distributed fairly to the trust’s beneficiary is taxable to those beneficiaries and is deductible by the trust.

However, where the trustor or the creator of a trust has retained so many of the incidents of ownership in respect to the property transferred so as to remain, in effect, their owner, the trustor-creator for tax purposes is then treated as if he still owned the properties, and he is required to include the income from such properties [300] in his own personal tax return.

As I have just indicated, a trustee may be recognized as a partner for income tax purposes under the general principles relating to a family partnership so long as his ownership of a capital interest in the partnership is real and not merely such in form. A trustee who is unrelated to and who is in-

dependent of the grantor, and who participates as a partner and receives distribution of the income distributable to a trust will ordinarily be recognized as the legal owner of the partnership interest which he holds in trust unless the grantor has retained such controls inconsistent with such ownership and the trustee is subservient to the directions and wishes of the trustor.

If a trustee is amenable to the will of the grantor, then the provisions of the trust agreement, particularly as to whether the trustee is subject to the responsibilities of a fiduciary, the provisions of the partnership agreement and the conduct of the parties must all be taken into account in determining whether the trustee in a fiduciary capacity has become the real owner of the partnership interest or whether the trustee is subservient to the directions and wishes of the trustor who has retained substantial dominion and control over the trust and, for practical purposes, is still owner of the interest. Even [301] if a trustee is amenable to the will of the grantor, the trust may nevertheless be recognized as a partner if the trustee in his participation in the affairs of the ownership actively represents and protects the interest of the beneficiaries and does not subordinate such interest to the interest of the grantor. Moreover, if the trustee is amenable to the will of the grantor, the following factors should be given special consideration: Whether the trust is recognized as a partner in business dealing with important customers and creditors, and whether, if any amount of the partnership income is

not properly retained for the reasonable needs of the business, the trust's share of such amount is distributed to the trust annually and paid to the beneficiaries or reinvested with regard solely to the interest of the beneficiary, or, in short, how were these purported interests actually dealt with in the conduct of this family business? If they were conducted in a manner consistent with its being the trustee-partners being a true and valid partner in a business enterprise and conducting themselves as such as would normally be the case if they were truly such, the relationship is valid for tax purposes. On the other hand, if the manner in which this business was conducted was in important particulars inconsistent with a valid relationship of that kind in the normal sense, then these are factors that [302] must be taken into account by you in considering your ultimate answer to the question presented to you.

In weighing the effect of any retention of control or power upon the bona fideness of the transaction, it must be distinguished from its power or control retained for the benefit of others as contrasted to the retention of control or power for the benefit of the donor. Retentions of control for the benefit of the donee, of course, would militate in favor of the bona fideness of the relationship. Retention of controls for the benefit of the donor would militate against the bona fideness.

The basic test which you should apply in determining whether either one or the other or both of the respective trustees was subservient to the wishes

of the other as trustor is not whether either of them actually was hostile or even adverse to the actions of the other. Rather, it is whether or not each in his own right and capacity as a trustee was truly independent in thought and action and whether his actions and decisions were based on his own independent view of what action would be best for the respective beneficiaries of trusts which he administered.

Here again, isolated facts should not be considered determinative by you. Rather, your answer should be based on all the evidence and any reasonable inferences which can be drawn from the evidence. [303]

When you retire to the jury room it will be your duty to select one of your number to act as your foreman who will speak for the jury when called upon to do so, and who will sign the verdict when it has been agreed to.

The verdict must be unanimous, all twelve must agree in the verdict to be returned. No verdict can be returned without such unanimous finding by all.

We have prepared a form of verdict for you which, I am sure, you will have no difficulty in following, and which I have already, to some extent, elaborated upon, but I will read it again to you because this will now bring to your mind the final summary of what you are to decide in the case.

The verdict reads, "We, the jury, empanelled in the above-entitled cause find as below stated: On a consideration of all facts and circumstances shown by the evidence and under the law given you by the

Court, do you find the status of Kuney, Sr., and Kuney, Jr., in their trustee capacity separate and apart from their personal capacity as partners in the Kuney family partnership genuine, bona fide, and valid for income tax purposes? Answer yes or no."

If you find them bona fide and genuine and valid, you will answer yes. If you find them otherwise, you will answer no. [304]

When you have reached your conclusion about it, the foreman will fill in the word here yes or no, sign the verdict and date it, and today is the 23rd of November.

Now, you should not single out any particular thing that I have told you, but keep in mind all I have told you is to be treated and accepted as a whole as being the principles of law applicable to the case. Of course, you will have with you in the jury room all of the exhibits which have been admitted in the case, including, incidentally, a photograph of the blackboard which has been admitted in evidence. So much reference was made to it during the discussion and the examination that I thought it would be helpful to you to have this before you, and, therefore, this is a photograph of the blackboard.

Now, ladies and gentlemen, in conclusion let me remind you that it is your duty to weigh the evidence calmly and dispassionately, to regard the interest of the parties to the litigation as the interest of strangers to you, to decide the issues solely upon their merits and upon the evidence which has been given you here and the law appli-

cable thereto. You should arrive at your conclusions here without any consideration whatever of the financial ability of the parties or as to what effect, if any, it may have upon their future welfare.

You should not permit either sympathy or considerations [305] of that kind on the one hand, or prejudice or bias on the other to have any place in your deliberations. This is a question of fact. Whatever result that may be, it is your duty to state it now by returning your verdict according to the evidence and the law, which I am sure you will do.

Let the Bailiffs be sworn.

(Whereupon, the Bailiffs were duly sworn.)

The Court: Let the jury retire with the exception of the alternates.

(Whereupon, the jury retired to deliberate at 10:37 o'clock a.m.)

(Whereupon, the alternate jurors were excused.)

The Court: Do you have any exceptions to the charge, gentlemen?

Mr. Toole: If the Court please, the plaintiffs would take exception to the charge that indicated a business purpose—that the business had to be benefited by the partners, or indicated there need to be a business purpose in connection with the formation of the partnership.

The Court: That was only an element to be considered. I didn't say they needed to be. I said it was one of the elements to be considered.

Are there any exceptions, Mr. Anderson? [306]

Mr. Anderson: I have only one, your Honor, which is defendant's requested instruction No. 9, which you partially covered.

The Court: What is it about?

Mr. Anderson: It is, "Trusts and family partnerships must have substance as well as form to be recognized for tax purposes; and this is particularly true where the trust beneficiary is a minor, the trustee is a donor whose accounts need not be supervised by a judicial or otherwise independent tribunal, the purported donors acting in one capacity or another are the only partners, and there is no apparent motive or reason for creating the trust and the partnership except for tax avoidance purposes."

The Court: Very well. Exceptions are noted for the record.

(Whereupon, the court recessed subject to call.) [307]

Certificate

I, Gerald J. Popelka, official court reporter in and for the United States District Court, Western District of Washington, do hereby certify that the foregoing transcript of proceedings is a full, true, and correct transcript of proceedings had in the within-entitled and numbered cause in the above-entitled court on the date hereinbefore set forth.

I do hereby certify that the foregoing transcript of proceedings has been prepared by me or under my direction.

/s/ GERALD J. POPELKA.

[Endorsed]: Filed April 4, 1961.

[Title of District Court and Cause.]

TRANSCRIPT OF PROCEEDINGS

Transcript of Proceedings had in the above-entitled and numbered causes in the above-entitled court before the Honorable George H. Boldt, United States District Judge, on Wednesday, March 22, 1961, at the United States Courthouse, Seattle, Washington.

* * *

The Court: As a general proposition I have found that I am never better able to decide a case to the maximum of my capabilities, humble as they are, than I am at the conclusion of the argument and after having carefully examined the memoranda and authorities that may have been submitted during the course of the trial or in connection with an argument. That has been done in this case.

Tax cases seem, for one reason or another, to be an exception to my general rule, not so much that I feel the need of delay in rendering decision, but because so often counsel request leave to submit

memoranda after argument and thus force me into the position of having to prepare a written decision at a later time. This particular case is an exception to the exception, and, therefore, for better or for worse, I intend to give you at this time my view of the questions presented by the motions for judgment notwithstanding the verdict, or, in the alternative, new trial.

Speaking extemporaneously and without notes, I do not propose to make a dissertation on all of the several points that have been raised, nor enlarge upon the detail of the evidence and facts indisputably shown and the evidence pertaining thereto. I have a clear and firm conclusion in my mind as to the ultimate decision required and will only generally indicate the basis thereof.

Under the portion of the charge to the jury reported at Pages 297 and 298 of the transcript, to which no exception was taken by either plaintiffs or defendant, the matter of bona fides in the creation of the trust in question is the matter to be determined on the over-all showing presented by the evidence on consideration of the several specific factors referred to in the instructions:

1. Retention of controls, either direct or indirect, by donor over income distributions, assets essential to partnership business, management powers, et cetera;

2. Indirect control exercised by the donor through either a separate business enterprise trust, et cetera;

3. Participation in the partnership by the donee. In this instance, of course, the trustee.

4. The manner of making partnership income distributions;

5. The actual manner in which the partnership business was conducted;

6. Control of business properties, assets, et cetera;

7. The reasonableness of salary and other compensation paid to the partners.

A further factor was included in the instruction; namely, whether or not there was a true business purpose for the formation of the partnership, but plaintiffs took exception to the inclusion of that particular element, and, therefore, it could not be considered to be a part of the law of the case. Hence I make no further reference thereto.

Conceding that in the record there is some evidence not inherently incredible which might support a fact finding favorable to plaintiffs on one or more of the factors referred to, it appears clear to me that a finding favorable to plaintiffs on the vital element pertaining to retention and exercise of control, referred to in two or three of the factors, is positively negated by the evidence, and there is no evidence whatever to support the finding favorable to plaintiffs as to those elements. A finding adverse to plaintiffs as to a factor or two of only incidental importance might not and probably would not preclude a general verdict in favor of the plaintiffs as a matter of law. On the other hand, when a basic general issue must be determined in

the light of findings on several factors of varying significance and importance, that now being established as the law of this particular case, and vital factors pertaining to the issue are negative and the Court has the clear and firm conviction that the evidence as a whole is not sufficient to sustain plaintiffs' affirmative burden of proof on that basic issue, it is the duty of the Court to set aside the verdict as not supported by substantial evidence and to grant a judgment for defendant notwithstanding the verdict.

I had such conviction at the end of the trial and when the verdict was received. Now, after a full, careful, and objective consideration of the matter, I still have the same conviction, and therefore, must hold and find that there is insufficient evidence to support judgment for the plaintiffs.

Accordingly, the verdict of the jury is set aside and notwithstanding the verdict, it is directed that judgment be entered for defendant dismissing the actions. However, if an appellate court find otherwise than as I have just stated and it be held that the evidence did present a fact issue for determination of the jury, and that there is evidence sufficient to sustain the verdict of the jury, then I am not disposed to substitute my judgment for that of the jury on that issue. Therefore, I see no reason for granting a new trial applicable in the event the judgment notwithstanding the verdict be vacated on appeal. Defendant's alternative motion for new trial is denied.

It is so ordered. Exceptions allowed.

Recess subject to call.

(Whereupon, the Court recessed subject to call.)

[Endorsed]: Filed April 4, 1961.

PLAINTIFF'S EXHIBIT No. 1

Trust Agreement

This Agreement, Made and entered into this 11th day of February, 1952, by and between Max J. Kuney, Jr., and Constance K. Kuney, husband and wife, parties of the first part, hereinafter sometimes referred to as "Grantors," and Max J. Kuney, party of the second part, hereinafter sometimes referred to as the "Trustee,"

Witnesseth:

Whereas, Max J. Kuney, Jr., is in the general contracting business, carrying on such business in partnership with others under the firm names of Max J. Kuney Company, Kuney Johnson Company, Agutter Electric Company and Tecler Aluminum Products; and

Whereas, it is the intention of the Grantors to make a gift in trust for the benefit of their minor children and others of a percentage of their interest in each of said partnership businesses; and

Whereas, it is the intention of the Grantors that the sum of such percentages so to be given by them

in trust for the benefit of their minor children and others shall equal \$100,000.00 in value.

Now, Therefore, for and in consideration of the sum of \$1.00 paid by the Trustee to the Grantors, receipt whereof is hereby acknowledged, and in further consideration of the covenants of the parties herein contained,

It is agreed that from the capital accounts of Max J. Kuney, Jr., Grantors shall forthwith cause to be placed to the credit of the Trustee, \$100,000.00 under capital accounts captioned "Max J. Kuney, Trustee" on the firm books of the businesses of Grantors, which said sum equals approximately 20 per cent of their interest in said businesses. The crediting of said amount to the account of the Trustee shall constitute the paying over, assigning, transferring and delivering to the Trustee of said sum and the receipt of the same by the Trustee.

It is further agreed that the Trustee shall hold and administer said sum and all other property that may from time to time be delivered to him, and the proceeds thereof and all increments thereof, and all property received in exchange for or purchased or acquired with the proceeds of such sum or property, or any part thereof (all of which is sometimes herein designated as the "trust estate") as Trustee for the purposes, upon the trust and subject to the terms, covenants, conditions and provisions hereafter set forth, that is to say:

Article I.

The Trustee shall divide the trust estate into two equal funds, one for the benefit of Max Jeffrey Kuney III, son of Grantors, and one for the benefit of Caroline Ireland Kuney, daughter of the Grantors. Each of said funds shall be deemed to be and shall be administered as a separate trust.

Article II.

The Trustee shall hold, manage, invest and re-invest the funds of the trust estate, shall receive the income therefrom and shall, after paying the reasonable and proper expenses of the trust, pay and distribute the principal thereof, and the income therefrom, as follows:

Section 1. The Trustee shall have the right in his sole and uncontrolled discretion to pay to Lorraine B. Kuney, mother of the Grantor, Max J. Kuney, Jr., to Clayton H. Bently, grandfather of the Grantor, Max J. Kuney, Jr., and to Mabel C. Bently, grandmother of the Grantor, Max J. Kuney, Jr., or to any of them, such portion or portions of the income of the trust estate as the Trustee may deem necessary to provide for the support, health, maintenance, welfare and enjoyment of such person or persons, due regard being given by the Trustee to the other sources of income of such persons. Any payments so made by the Trustee shall be charged equally to the two funds into which the trust estate is divided and shall be paid from the net income of said funds. The Trustee's determination as to

whether or not payments shall be made to the persons named in this section and the amount of such payments shall not be subject to judicial review.

Section 2. The Trustee shall pay the net income upon each share or fund of the trust estate remaining after any payments provided for in Section 1 of this Article to the child of Grantors for whose benefit such share or fund is set aside at quarterly or other convenient intervals.

Section 3. The Trustee shall have the right at any time, and from time to time, after a child of Grantors for whom a share or fund of the trust estate is set aside attains the age of twenty-one (21) years, to pay over, transfer, assign, convey and deliver unto such child all or any portion of the share or fund then being held for the benefit of such child, as the Trustee, in his sole and absolute discretion, deems to be for the best interest of said child. At the discretion of the Trustee such distribution may be made irrespective of whether the persons named in Section 1 of this Article shall still be living.

Section 4. Should either of Grantors' children die prior to receiving the principal of the fund set aside for the benefit of such child, leaving issue him or her surviving, then and in such event the fund for the benefit of such child so dying shall be held for the benefit of the issue of such child, and the net income therefrom shall be paid to, or, in the discretion of the Trustee, applied for the benefit of

the issue of such child in equal shares per stirpes until the youngest child of such child so dying shall have attained the age of twenty-one (21) years, or would, if living, have attained the age of twenty-one (21) years, whereupon the principal of such fund shall be paid, transferred, assigned, conveyed and delivered to the issue of such child so dying in equal shares per stirpes and not per capita.

Section 5. Should either of Grantors' said children die prior to receiving the principal of the fund for such child provided, without issue him or her surviving, or in the event of the failure of such issue prior to final distribution of such child's share or portion of the trust estate, then and in that event the fund or portion of the trust estate set aside for the benefit of such child so dying shall be added to the share or fund held for the benefit of Grantors' other child.

Section 6. In the event of the death of both of Grantors' said children prior to final distribution of the trust estate, leaving no issue them surviving, or in the event of the failure of such issue prior to final distribution of the trust estate, the Trustee shall pay over, transfer, assign, convey and deliver the trust estate then remaining in his hands to the heirs at law of the last survivor of Grantors' said children as the same shall be determined under the laws of descent and distribution of the State of Washington at the time of the death of said last survivor.

Section 7. Whenever any person under the age of thirty (30) years shall, under the provisions of this article, be entitled to receive or to have the use or application of any part of the net income of the trust estate, the Trustee may use and apply all or such part as to him shall seem best of such net income for or towards the maintenance, education, enjoyment, health and welfare of such person until such person attains the age of thirty (30) years, and the Trustee during such time as such person is under the age of twenty-one (21) years, may either so use and apply the same himself, or, in his discretion, pay the same or any part thereof to such person or to the guardian or parent of such person for the use and benefit of such person, without any responsibility for the application thereof by such guardian or parent. The amount of such net income so paid over to or used or applied for the benefit of such person under the age of thirty (30) years shall be determined by the Trustee in his sole and absolute discretion. Any part of such net income not so paid over, used or applied as aforesaid shall be accumulated by the Trustee and added to the principal of the fund or share of the trust estate then being held for such person's benefit.

Article III.

No money or property (either principal or income) payable or distributable under the provisions of this trust agreement shall be pledged, assigned, transferred, sold or in any manner anticipated,

charged or encumbered by any of the beneficiaries hereunder, or be in any manner liable in the possession of the Trustee for the debts, contracts, obligations or engagements of such beneficiaries, voluntary or involuntary, or for any claim, legal or equitable, against any beneficiary, including claims for alimony or for the support of any spouse.

Article IV.

Section 1. The Trustee shall at all times during the continuance of the trust hereby created collect all the income, issues and profits of the trust estate, and shall pay all taxes, assessments and other legal charges upon all property of the trust estate and all expenses growing out of the execution of the trust or the exercise of the powers hereby conferred, and shall pay when due all interest on all indebtedness of the trust estate, secured or unsecured, and shall have full power at all times to settle and compromise all claims or demands of or against the trust estate, and his receipt in full satisfaction of any claim of said trust estate shall be sufficient evidence of the full discharge of such claim.

Section 2. The Trustee shall have the following powers, discretion and authority:

(a) To sell, exchange or dispose of the property of the trust estate for cash or wholly or partly on credit for such price and on such terms as he shall see fit; to invest and reinvest the trust estate in such property as to him in his entire discretion shall

seem fit, including but without in any way being limited to stocks (common or preferred) bonds, notes, secured or unsecured, real or personal property and beneficial interest therein and including non-income producing property; and to change any investment from time to time without in any case being limited by any statute or rule of law regarding investments by trustees; to retain as investments any property or securities the Trustee may receive or purchase regardless of the risk therein or whether they or any portion thereof shall at any time constitute a large portion of the trust estate; to loan funds of the trust estate to any person, partnership, corporation, estate or trust with or without security; to vote (by proxy or in person) with respect to any stock or other security, to deposit any stock or other security with or under the direction of any committee or other agency formed to protect such stock or security; and otherwise to take any action he deems best with regard to reorganizations, consolidations, mergers or other changes of corporation, and to pay any expenses or assessments in connection therewith; to determine in his discretion whether to exercise or to dispose of or to reject rights to subscribe to stock or securities under pre-emptive or other rights, or to exercise options of taking dividends in cash, stock or other property; to place and keep stock, securities or other property in the custody of any depositary and in the name of the Trustee or his nominees with or without disclosing any fiduciary relationship for the purpose of making any division of the trust estate

to allot to any fund or share any property of the trust estate or an undivided interest in such property, and to make joint investments for the several funds and shares of the trust estate, and so long as it can advantageously be done, to hold all or part of the investments of the trust as a common fund and divide the net income proportionately; for the purpose of raising funds for the payment of taxes or protecting investments already held or paying, extending or renewing any indebtedness, exercising pre-emptive or other rights of stockholders, subscribing for stock or securities or for any purpose whatsoever deemed by the Trustee advantageous for the trust estate, to borrow such sums of money as he may deem expedient and to secure payment thereby by mortgage, pledge or hypothecation of any property of the trust estate; to appoint and fix compensation for and delegate authority to such attorneys, agents, servants, proxies and depositaries as he may see fit, and in the event additional trustees are appointed as hereinafter provided, to authorize one or more of the trustees to act for all of them.

(b) To lease any real estate or sublease any leasehold property on such covenants as the Trustee may deem advisable and for any term regardless of the term of the trust hereby created; to improve real estate and tear down and alter improvements; to make contracts for or in relation to foundations, party walls, building restrictions and easements; to relinquish, convey or assign any right, title or

interest in, to or about any property of the trust estate, to insure all buildings and land and income therefrom against loss by fire or other casualty, and himself as Trustee against any liability for accidents and to pay the cost of such insurance; whenever in his discretion it may be desirable to convey or cause to be conveyed any real estate to any nominee or nominees of the Trustee and with or without disclosing any trust relationship.

Section 3. In general the Trustee is given as full and complete power and authority over the trust estate as fully and to the same extent as any individual might, could or would have owning similar properties and securities in his own right.

Section 4. An entry upon the books of the Trustee allotting to any fund or share any of the assets of the trust estate, or an undivided part of any asset or group of assets not conveniently divisible shall be sufficient to effectuate such allotment without taking such assets in the name of the fund or share.

Section 5. Upon all questions as to what constitutes income of the trust estate, the decision of the Trustee shall be conclusive. The Trustee is authorized to determine in case of all investments purchased or sold at a premium or discount whether such premium or discount shall be credited to or charged against principal or income or partly against principal and partly against income. All stock dividends received by the Trustee on any

shares of stock shall be reckoned as principal provided that if the Trustee is satisfied that any such stock dividend is paid out of current earnings wholly or partly in lieu of current cash dividends, he may designate and treat such dividends or part thereof as income.

Section 6. No Trustee hereunder shall ever be held responsible for any default of any other person or for any loss sustained by the trust estate through any error of judgment or in any other manner except through his own breach of good faith. No Trustee hereunder shall ever be personally liable upon any contract of indebtedness of the trust estate or upon any mortgage, trust deed, note or other instrument executed hereunder. No Trustee hereunder shall be required to give a bond as such Trustee.

Section 7. No person paying money or delivering any property to the Trustee shall be required to see to the application thereof. The Trustee may determine the annual accounting period for the trust estate which shall be deemed the "year" of the trust estate for all purposes.

Section 8. The Trustee hereunder, his successors and substitutes, shall be and he is hereby relieved from any and all of the duties imposed upon them by Chapter 229 of the Laws of 1941 of the State of Washington, as amended. Such Trustee, his successors or substitutes, shall further be relieved from any and all duties so far as the Grant-

ors are able by this instrument to relieve him, which may in the future be imposed by amendment to said Chapter 229 of the Laws of 1941 of the State of Washington, or by any future law or laws of the State of Washington, or by any existing or future law or any other state with respect to making or filing with any court or other place any report, inventory or accounting of the principal or income of the trust hereby created.

Article V.

In the event of the death, resignation, refusal or inability of the Trustee named hereunder to act for any cause, he shall be succeeded by Max J. Kuney, Jr., one of the Grantors, as successor Trustee. While Max J. Kuney, Jr., is acting as Trustee hereunder he shall have the right at any time, and from time to time, to appoint one or more additional trustees and the right to appoint a successor trustee or trustees. In the event of the failure of Max J. Kuney, Jr., to appoint such additional or successor trustee or trustees, or in the event of the death, resignation, refusal or inability of all such trustees to act hereunder, Max J. Kuney, Jr., having for any reason ceased to act as Trustee, the Seattle First National Bank, acting by and through its Spokane & Eastern Branch, shall thereupon be and become the successor Trustee. Any additional or successor trustee or trustees shall have and exercise all the powers, authority, discretion, duties and obligations herein conferred upon and entrusted to

the Trustee. The Trustees shall serve without bond and shall be entitled to reasonable compensation.

Article VI.

The trust hereby created shall be irrevocable.

Article VII.

The party of the second part, by executing this agreement, does hereby accept the trust herein declared and created and agrees to carry out the provisions hereof on his part to be performed.

In Witness Whereof, the parties hereto have executed agreement in triplicate the day and year first above written.

/s/ MAX KUNEY, JR.,

/s/ CONSTANCE W. KUNEY,
Grantors.

/s/ MAX J. KUNEY,
Trustee.

Admitted in evidence November 21, 1960.

PLAINTIFF'S EXHIBIT No. 2

Trust Agreement

This Agreement, made and entered into this 11th day of February, 1952, by and between Max J. Kuney, party of the first part, hereinafter sometimes referred to as "Grantor," and Max J. Kuney,

Jr., party of the second part, hereinafter sometimes referred to as the "Trustee."

Witnesseth:

Whereas, Max J. Kuney is in the general contracting business, carrying on such business in partnership with others under the firm names of Max J. Kuney Company, Kuney Johnson Company, Agutter Electric Company and Tecler Aluminum Products; and

Whereas, it is the intention of the Grantor to make a gift in trust for the benefit of his minor child, John Richardson Kuney, of a percentage of his interest in each of said partnership businesses; and

Whereas, it is the intention of the Grantor that the sum of such percentages so to be given by him in trust for the benefit of his minor child shall equal \$100,000.00 in value.

Now, Therefore, for and in consideration of the sum of \$1.00 paid by the Trustee to the Grantor, receipt whereof is hereby acknowledged, and in further consideration of the covenants of the parties herein contained,

It is agreed that from the capital accounts of Max J. Kuney, Grantor shall forthwith cause to be placed to the credit of the Trustee, \$100,000.00 under capital account captioned "Max J. Kuney, Jr., Trustee" on the firm books of the businesses of Grantor, which said sum equals approximately 20

per cent of his interest in said businesses. The crediting of said amount to the account of the Trustee shall constitute the paying over, assigning, transferring and delivering to the Trustee of said sum and the receipt of the same by the Trustee.

It is further agreed that the Trustee shall hold and administer said sum and all other property that may from time to time be delivered to him, and the proceeds thereof and all increments thereof, and all property received in exchange for or purchased or acquired with the proceeds of such sum or property, or any part thereof (all of which is sometime herein designated as the "trust estate") as Trustee for the purposes, upon the trust and subject to the terms, covenants, conditions and provisions hereafter set forth, that is to say:

Article I.

The Trustee shall hold, manage, invest and reinvest the funds of the trust estate, shall receive the income therefrom, and shall, after paying the reasonable and proper expenses of the trust, pay and distribute the principal thereof, and the income therefrom, as follows:

Section 1. The Trustee shall pay Olive R. Kuney none per month toward the support and maintenance of John Richardson Kuney from January 1, 1952, during the period of time she has his actual physical custody and he is residing in her home and with her; providing if and when he is living away

from her home in school or college said payments shall continue.

Section 2. The Trustee shall pay the net income of the trust estate remaining after the payments provided for in Section 1 of this Article to John Richardson Kuney at quarterly or other convenient intervals.

Section 3. The Trustee shall have the right at any time, and from time to time, after John Richardson Kuney attains the age of twenty-one (21) years, to pay over, transfer, assign, convey and deliver unto John Richardson Kuney all or any portion of the share or fund then being held for the benefit of John Richardson Kuney as the Trustee, in his sole and absolute discretion, deems to be for the best interest of John Richardson Kuney.

Section 4. In the event of the death of John Richardson Kuney prior to his receiving all of the principal of the Trust Estate, the principal then remaining in the hands of the Trustee shall be held for the benefit of the issue of John Richardson Kuney, and the net income therefrom shall be paid to or, in the discretion of the Trustee, applied for the benefit of the issue of said John Richardson Kuney in equal shares per stirpes, until the youngest child of John Richardson Kuney shall have attained the age of twenty-one (21) years, or would, if living, have attained the age of twenty-one (21) years, whereupon the principal of the Trust Estate shall be paid over, transferred, assigned, conveyed

and delivered to the issue of John Richardson Kuney in equal shares per stirpes and not per capita.

Section 5. In the event of the death of John Richardson Kuney prior to final distribution of the Trust Estate, leaving no issue him surviving, or in the event of the failure of such issue prior to the final distribution of the Trust Estate, the Trustee shall thereafter pay the net income of the Trust Estate to the issue of Max J. Kuney, Jr., in equal shares per stirpes until the youngest child of said Max J. Kuney, Jr., shall attain the age of twenty-one (21) years or would, if living, have attained the age of twenty-one (21) years, whereupon the principal of the Trust Estate shall be paid over, transferred, assigned, conveyed and delivered to the issue of said Max J. Kuney, Jr., in equal shares per stirpes and not per capita.

Section 6. Whenever any person under the age of thirty (30) years shall, under the provisions of this article, be entitled to receive or to have the use or application of any part of the net income of the Trust Estate, the Trustee may use and apply all or such part as to him shall seem best of such net income for or towards the maintenance, education, enjoyment, health and welfare of such person until such person attains the age of thirty (30) years, and the Trustee, during such time as such person is under the age of twenty-one (21) years, may either so use and apply the same himself or, in his discretion, pay the same or any part thereof

to such person or to the guardian or parent or person having custody of such person for the use and benefit of such person, without any responsibility for the application thereof by such guardian, parent, or person having custody. The amount of such net income to be so paid over to or used or applied for the benefit of such person under the age of thirty (30) years shall be determined by the Trustee in his sole and absolute discretion. Any part of such net income not so paid over, used or applied as aforesaid shall be accumulated by the Trustee and added to the principal of the fund or share of the Trust Estate then being held for such person's benefit.

Section 7. Wherever used in this article, the terms "child," "children" and "issue" shall include persons who are adopted.

Article II.

No money or property (either principal or income) payable or distributable under the provisions of this trust agreement shall be pledged, assigned, transferred, sold, or in any manner anticipated, charged or encumbered by any of the beneficiaries hereunder, or be in any manner liable in the possession of the Trustee for the debts, contracts, obligations or engagements of such beneficiaries, voluntary or involuntary, or for any claim, legal or equitable, against any beneficiary, including claims for alimony or for the support of any spouse.

Article III.

Section 1. The Trustee shall, at all times during the continuance of the trust hereby created, collect all the income, issues and profits of the Trust Estate, and shall pay all taxes, assessments and other legal charges upon all property of the Trust Estate and all expenses growing out of the execution of the trust or the exercise of the powers hereby conferred, and shall pay when due all interest on all indebtedness of the Trust Estate, secured or unsecured, and shall have full power at all times to settle and compromise all claims or demands of or against the Trust Estate, and his receipt in full satisfaction of any claim of said Trust Estate shall be sufficient evidence of the full discharge of such claim.

Section 2. The Trustee shall have the following powers, discretion and authority:

(a) To sell, exchange or dispose of the property of the Trust Estate for cash or wholly or partly on credit for such price and on such terms as he shall see fit; to invest and reinvest the Trust Estate in such property as to him in his entire discretion shall seem fit, including but without in any way being limited to stocks (common or preferred), bonds, notes, secured or unsecured, real or personal property and beneficial interest therein and including non-income-producing property; and to change any investment from time to time without in any case being limited by any statute or rule of law regarding investments by trustees; to retain as in-

vestments any property or securities the Trustee may receive or purchase regardless of the risk therein or whether they or any portion thereof shall at any time constitute a large portion of the Trust Estate; to loan funds of the Trust Estate to any person, partnership, corporation, estate or trust with or without security; to vote (by proxy or in person) with respect to any stock or other security, to deposit any stock or other security with or under the direction of any committee or other agency formed to protect such stock or security; and otherwise to take any action he deems best with regard to reorganizations, consolidations, mergers or other changes of corporation, and to pay any expenses or assessments in connection therewith; to determine in his discretion whether to exercise or to dispose of or to reject rights to subscribe to stock or securities under pre-emptive or other rights, or to exercise options of taking dividends in cash, stock or other property; to place and keep stock, securities or other property in the custody of any depository and in the name of the Trustee or his nominees with or without disclosing any fiduciary relationship; for the purpose of making any division of the Trust Estate to allot to any fund or share any property of the Trust Estate or an undivided interest in such property, and to make joint investments for the several funds and shares of the Trust Estate, and, so long as it can advantageously be done, to hold all or part of the investments of the trust as a common fund and divide the net income proportionately; for the purpose

of raising funds for the payment of taxes or protecting investments already held or paying, extending or renewing any indebtedness, exercising pre-emptive or other rights of stockholders, subscribing for stock or securities or for any purpose whatsoever deemed by the Trustee advantageous for the Trust Estate, to borrow such sums of money as he may deem expedient and to secure payment thereby by mortgage, pledge or hypothecation of any property of the Trust Estate; to appoint and fix compensation for and delegate authority to such attorneys, agents, servants, proxies and depositaries as he may see fit, and, in the event additional trustees are appointed as hereinafter provided, to authorize one or more of the trustees to act for all of them.

(b) To lease any real estate or sublease any leasehold property on such covenants as the Trustee may deem advisable and for any term regardless of the term of the trust hereby created, to improve real estate and tear down and alter improvements; to make contracts for or in relation to foundations, party walls, building restrictions and easements; to relinquish, convey or assign any right, title or interest in, to or about any property of the Trust Estate, to insure all buildings and land and income therefrom against loss by fire or other casualty, and himself as Trustee against any liability for accidents and to pay the cost of such insurance; whenever in his discretion it may be desirable, to convey or cause to be conveyed any real estate to any

nominee or nominees of the Trustee and with or without disclosing any trust relationship.

Section 3. In general the Trustee is given as full and complete power and authority over the Trust Estate as fully and to the same extent as any individual might, could or would have owning similar properties and securities in his own right.

Section 4. An entry upon the books of the Trustee allotting to any fund or share any of the assets of the Trust Estate, or an undivided part of any asset or group of assets not conveniently divisible, shall be sufficient to effectuate such allotment without taking such assets in the name of the fund or share.

Section 5. Upon all questions as to what constitutes income of the Trust Estate, the decision of the Trustee shall be conclusive. The Trustee is authorized to determine in case of all investments purchased or sold at a premium or discount whether such premium or discount shall be credited to or charged against principal or income or partly against principal and partly against income. All stock dividends received by the Trustee on any shares of stock shall be reckoned as principal provided that, if the Trustee is satisfied that any such stock dividend is paid out of current earnings wholly or partly in lieu of current cash dividends, he may designate and treat such dividends or part thereof as income.

Section 6. No Trustee hereunder shall ever be

held responsible for any default of any other person or for any loss sustained by the Trust Estate through any error of judgment or in any other manner except through his own breach of good faith. No Trustee hereunder shall ever be personally liable upon any contract of indebtedness of the Trust Estate or upon any mortgage, trust deed, note or other instrument executed hereunder. No Trustee hereunder shall be required to give a bond as such Trustee.

Section 7. No person paying money or delivering any property to the Trustee shall be required to see to the application thereof. The Trustee may determine the annual accounting period for the Trust Estate which shall be deemed the "year" of the Trust Estate for all purposes.

Section 8. The Trustee hereunder, his successors and substitutes, shall be and he is hereby relieved from any and all of the duties imposed upon them by Chapter 229 of the Laws of the State of Washington, as amended. Such Trustee, his successors or substitutes, shall further be relieved from any and all duties so far as the Grantors are able by this instrument to relieve him, which may in the future be imposed by amendment to said Chapter 229 of the Laws of 1941 of the State of Washington, or by any future law or laws of the State of Washington, or by any existing or future law of any other state with respect to making or filing with any court or other place any report, inventory or accounting of the principal or income of the trust hereby created.

Article IV.

In the event of the death, resignation, refusal or inability of the Trustee named hereunder to act for any cause, he shall be succeeded by Max J. Kuney, Grantor, as successor Trustee. While Max J. Kuney is acting as Trustee hereunder he shall have the right at any time, and from time to time, to appoint one or more additional trustees and the right to appoint a successor trustee or trustees. In the event of the failure of Max J. Kuney to appoint such additional or successor trustee or trustees, or in the event of the death, resignation, refusal or inability of all such trustees to act hereunder, Max J. Kuney having for any reason ceased to act as Trustee, the Seattle First National Bank, acting by and through its Spokane & Eastern Branch, shall thereupon be and become the successor Trustee. Any additional or successor trustee or trustees shall have and exercise all the powers, authority, discretion, duties and obligations herein conferred upon and entrusted to the Trustee. The Trustees shall serve without bond and shall be entitled to reasonable compensation.

Article V.

The trust hereby created shall be irrevocable.

Article VI.

The party of the second part, by executing this agreement, does hereby accept the trust herein declared and created, and agrees to carry out the provisions hereof on his part to be performed.

In Witness Whereof the parties have executed this agreement in triplicate the day and year first above written.

/s/ MAX J. KUNEY,

Grantor,

/s/ MAX J. KUNEY, JR.,

Trustee.

Admitted in evidence November 21, 1960.

[Title of District Court and Cause.]

Civil Nos. 4990, 4991, and 4992

CERTIFICATE OF CLERK U. S. DISTRICT
COURT TO RECORDS ON APPEAL.

United States of America,
Western District of Washington—ss.

I, Harold W. Anderson, Clerk of the United States District Court for the Western District of Washington, do hereby certify that pursuant to the provisions of Subdivision 1 of Rule 10 of the United States Court of Appeals for the Ninth Circuit and Rule 75(o) FRCP, and designation of counsel, I am transmitting herewith the following original documents in the files of the above-referred-to cases dealing with the actions as the records on appeal herein to the United States Court of Appeals for the Ninth Circuit at San Francisco, said papers being identified as follows:

Cause No. 4990

1. Complaint filed Feb. 4, 1960, with exhibits A, B, C, D and E attached.

4. Answer, filed Apr. 4, 1960.

10. Pre-Trial Order, filed Nov. 7, 1960.

7. Defendant's Motion for Summary Judgment, filed July 5, 1960, with copies of trust agreements attached.

8-b. Affidavit of Max J. Kuney in Opposition to Defendant's Motion for Summary Judgment, filed July 22, 1960.

8-c. Affidavit of Max J. Kuney, Jr., in Opposition to Defendant's Motion for Summary Judgment, filed July 22, 1960.

9. Memorandum Decision on motion for summary judgment, filed Aug. 10, 1960.

17. Motion Defendant for Directed Verdict, filed Nov. 22, 1960.

18. Renewal of Defendant's Motion for a Directed Verdict, filed Nov. 22, 1960.

19. Verdict, filed Nov. 23, 1960.

21. Defendants' Motion for Judgment NOV or for New Trial, filed Nov. 25, 1960.

29. Judgment Notwithstanding the Verdict of the Jury, filed Apr. 24, 1961.

30. Notice of Appeal, filed May 19, 1961.

31. Bond for Costs on Appeal, filed May 19, 1961.

27. Court Reporter's Transcript of Proceedings commencing Nov. 21, 1960, filed Apr. 4, 1961.

28. Court Reporter's Transcript of Proceedings commencing March 22, 1961, filed Apr. 4, 1961.

34. Order Extending Time for Filing Record on Appeal and Docketing Appeal, to Aug. 17, 1961, filed Jun. 27, 1961.

35. Designation of Record on Appeal, filed Aug. 3, 1961.

Cause No. 4991

1. Complaint, filed Feb. 4, 1960, with Exhibits A, B, C, D and E attached.

4. Answer, filed Apr. 4, 1960.

5. Notice of Appeal, filed May 19, 1961.

6. Cost Bond on Appeal, filed May 19, 1961.

(Note: Other documents designated are included in the record in Cause No. 4990.)

Cause No. 4992

1. Complaint, filed Feb. 4, 1960, with exhibits A, B, C, and D attached.

4. Answer, filed Apr. 4, 1960.

5. Notice of Appeal, filed May 19, 1961.

6. Cost Bond on Appeal, filed May 19, 1961.

(Note: Other documents designated are included in the record in Cause No. 4990.)

Plaintiffs' Exhibits numbered 1 through 35;
Defendant's Exhibits lettered A through R inclusive;

Court Exhibits numbered 1 and 2.

I further certify that the following is a true and correct statement of all expenses, costs, fees and charges incurred in my office by or on behalf of the

appellants for preparation of the records on appeal in these causes, to wit:

Filing fee, Notice of Appeal, \$5.00 in each of causes numbered 4990, 4991 and 4992, and that said amount has been paid to me on behalf of appellants.

In Witness Whereof I have hereunto set my hand and affixed the official seal of said District Court at Seattle this 7th day of August, 1961.

[Seal] HAROLD W. ANDERSON,
Clerk.

By /s/ TRUMAN EGGER,
Chief Deputy.

[Endorsed]: No. 17507-8-9 United States Court of Appeals for the Ninth Circuit. Max Kuney, Jr., and Constance K. Kuney, his wife; Max J. Kuney, Sr., Olive R. Kuney, Appellants, vs. William E. Frank, District Director of Internal Revenue, Appellee. Transcript of Record. Appeals from the United States District Court for the Western District of Washington, Northern Division.

Filed August 14, 1961.

Docketed August 16, 1961.

FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
For the Ninth Circuit

No. 17507, No. 17508, No. 17509

MAX J. KUNEY, JR., and CONSTANCE K.
KUNEY, His Wife; MAX J. KUNEY, SR.,
OLIVE R. KUNEY,

Appellants,

vs.

WILLIAM E. FRANK, District Director of Inter-
nal Revenue,

Appellee.

STATEMENT OF POINTS TO BE RELIED
UPON BY THE APPELLANTS

Come Now Max J. Kuney, Jr. and Constance K. Kuney, his wife, Max J. Kuney, Sr., and Olive R. Kuney, by their attorneys, Warren V. Clodfelter and Allen A. Bowden, and pursuant to Rule 17 of the Rules of the United States Court of Appeals for the Ninth Circuit, hereby make the following statement of points relied upon by the appellants:

1. The District Court erred in overruling the verdicts of the jury that the trusts for the benefit of John R. Kuney, Max J. Kuney, III and Caroline I. Kuney, were genuine, bona fide and valid partners in the Kuney family partnership for income tax purposes.

Dated this 23rd day of August, 1961.

/s/ ALLEN A. BOWDEN,

/s/ WARREN V. CLODFELTER,

Attorneys for the Appellants.

Affidavit of service by mail attached.

[Endorsed]: Filed August 24, 1961.

[Title of Court of Appeals and Cause.]

Nos. 17507, 17508 and 17509

STIPULATION RE EXHIBITS

It is hereby stipulated, subject to the approval of the Court, that all exhibits admitted into evidence and not specifically designated for printing may be referred to by counsel in their respective briefs and in oral argument and considered by the Court with the same force and effect as if included in the printed record.

Dated: September 7, 1961.

/s/ ALLEN A. BOWDEN,
Counsel for Appellants.

/s/ JOHN B. JONES, JR.,
Acting Assistant Attorney General, Counsel for
Appellee.

So Ordered:

/s/ STANLEY N. BARNES,
Judge, U. S. Court of Ap-
peals for the Ninth Circuit.

[Endorsed]: Filed September 7, 1961.